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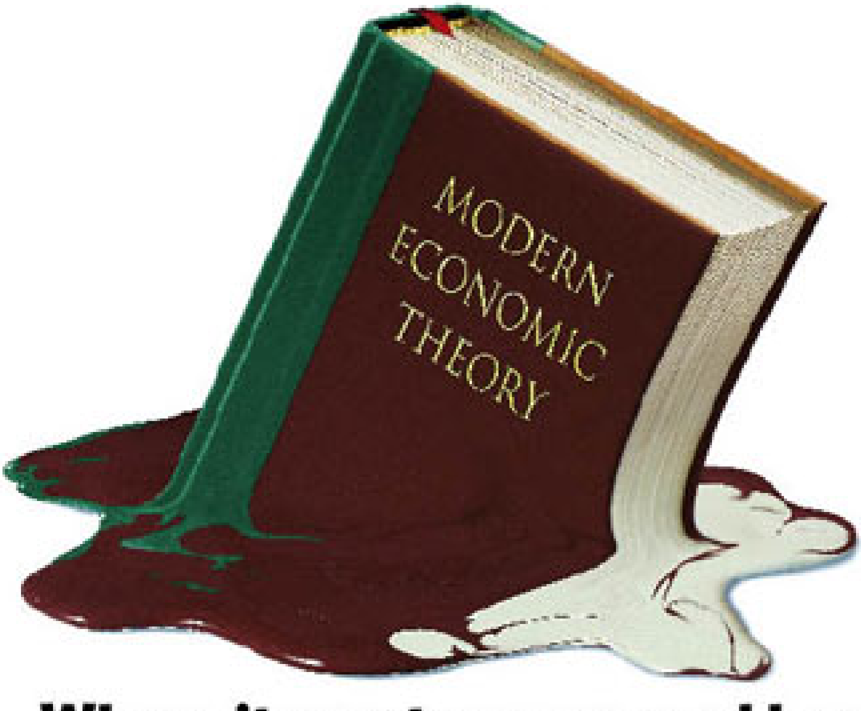

Where it went wrong–and how the crisis is changing it

Print edition July 18th 2009

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Politics this week

Jul 16th 2009
From The Economist print edition

Getty Images

America's Senate opened its confirmation hearings into **Sonia Sotomayor's** appointment to the Supreme Court. Though the hearings could go on for as long as two weeks, Ms Sotomayor is in no danger, thanks to the Democrats' solid majority and her own ultra-cautious defence of her views. See article

A version of **health-care reform** was passed by a health committee in the Senate. It provides much-extended coverage for Americans who lack it, and for a publicly provided competitor to private insurance schemes. But there is still a long way to go before a bill lands on Barack Obama's desk for signature. See article

There were reports that Eric Holder, the attorney general, is planning to appoint some form of prosecutor to determine whether CIA operatives illegally **tortured** terrorist suspects. See article

Qualifying welcome

Canada imposed rules requiring visas for all visitors from the Czech Republic and Mexico, following a surge in arrivals seeking refugee status. Most of the asylum-seekers from the Czech Republic are Roma.

Ahead of the resumption of mediation talks in Costa Rica, Manuel Zelaya, the ousted president of **Honduras**, declared in Guatemala that his followers would have "the right to insurrection" to see him restored to office.

In another example of **Mexico's** drugs-related violence, the tortured bodies of 12 federal police were found in Michoacán state, killed in apparent reprisal for the arrest on July 11th of a suspected drug boss. President Felipe Calderón said the government would not be intimidated in its war against the drug cartels.

Still fighting

Iran's thwarted presidential challenger, Mir Hosein Mousavi, was reported to be planning a new front with a former president, Akbar Hashemi Rafsanjani, the most powerful politician to have come out in opposition to President Mahmoud Ahmadinejad and the ruling clerical establishment. But as public protests continued to dwindle without actually ending, the authorities said the incumbent would be sworn in early next month. See article

A Caspian Airlines plane crashed in **Iran** shortly after taking off from Tehran, killing all 168 people on board. Investigators have recovered two of its three black boxes.

AP

Barack Obama went to **Ghana**, one of Africa's most successful countries, on his first fleeting visit to the continent as America's president. Outlining his vision for Africa, he stressed the need for good governance, damned corruption and said that it was mainly up to Africans to improve their lot. See article

Nigerian rebels belonging to the Movement for the Emancipation of the Niger Delta, better known as MEND, which says the federal government has impoverished people in the oil-rich Delta region, for the first time attacked the country's commercial capital, Lagos, killing eight navy guards and setting fire to fuel tanks. It then called a 60-day ceasefire.

Two French security officials were captured by rebels while trying to advise **Somalia's** beleaguered government in Mogadishu, which is under persistent attack from jihadists.

Professing his "love for humanity" and claiming he had fought all his life to "do what I thought was right in the interests of justice and fair play", Charles Taylor, **Liberia's** former president, launched his defence against 11 charges of war crimes and crimes against humanity at a UN-backed special court for Sierra Leone in The Hague. He is the first African leader to be tried in an international court.

South African construction workers ended a week-long strike over pay that had threatened to derail preparations for the 2010 soccer World Cup championship. Among the projects affected were new football stadiums and a high-speed rail link between Pretoria and Johannesburg.

Jaw, jaw once more

For the first time since terrorists attacked last year in Mumbai, the prime ministers of **India** and **Pakistan** met to talk about how to restart peace talks. See article

After Taro Aso's Liberal Democratic Party was humiliated in Tokyo's municipal elections—the ruling coalition lost its majority in the city's Assembly and the opposition Democratic Party of Japan became the largest party—**Japan's** prime minister called an early election for August 30th. Most polls suggest the LDP, which has ruled the country for 52 of the past 53 years, will lose heavily. See article

Turkey's prime minister, Recep Tayyip Erdogan, compared **China's** treatment of its Turkic-speaking Uighur minority in Xinjiang to genocide. China demanded that Australia not show a film about a Uighur leader in exile in America. See article

Kevin Rudd, Australia's prime minister, raised his government's alarm after **China** arrested some Shanghai-based executives of mining giant Rio Tinto-Zinc (including one Australian) and accused them of stealing state secrets. See article

A **South Korean** television station, citing unconfirmed and anonymous intelligence reports, claimed North Korea's leader, Kim Jong Il, was suffering from cancer of the pancreas, a disease that kills 80% of patients within a year.

Ebb and flow

AP

At a ceremony in Ankara, several countries, including Turkey, signed up to the planned **Nabucco** pipeline through south-eastern Europe. Nabucco is meant to diversify supplies by sending gas to Europe without it passing through Russia. See article

A fresh spate of killings hit **Chechnya**, in Russia's north Caucasus. Two policemen and two soldiers were shot dead in an ambush. And a prominent human-rights activist, Natalia Estemirova, was abducted and later found shot dead in neighbouring **Ingushetia**. See article

The last United Nations monitors left **Georgia's** disputed territories of South Ossetia and Abkhazia, after Russia had vetoed an extension of their mandate. **Russia's** president, Dmitry Medvedev, visited South Ossetia to promise support even as an American warship joined a military exercise off Georgia.

In its first plenary session, the newly elected **European Parliament** chose a former prime minister of Poland, Jerzy Buzek, to be its president. The conservative will step down after 30 months to make way for a socialist candidate. See article

Business this week

Jul 16th 2009
From The Economist print edition

Goldman Sachs surprised even optimistic analysts with a $3.44 billion profit for the three months to June, almost 90% more than the previous quarter. Profits were also up at **JPMorgan Chase**, which announced second-quarter profits of $2.7 billion on July 16th, which were 36% higher than a year ago. See article

A federal judge in Miami agreed to a request by the American and Swiss governments and **UBS**, Switzerland's largest bank by assets, to postpone to August 3rd hearings on the case brought against the bank by the American government to allow the two governments time to try to reach a settlement. The American government wants UBS to release the names of 52,000 clients, including several thousand very wealthy Americans with offshore bank accounts containing anything from tens of millions to hundreds of millions of dollars.

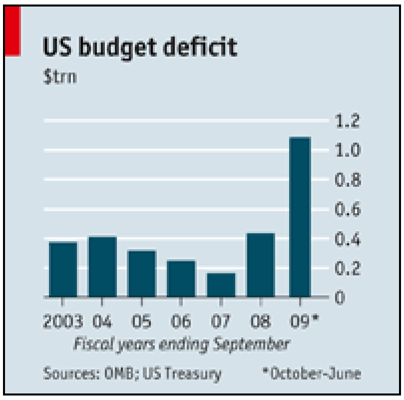
Reining them in

Proposed new rules for banks were outlined by the **European Commission** on July 13th. They included higher capital requirements for re-securitisations. Banks will be required to have "sound remuneration practices" that do not "encourage or reward excessive risk-taking". The **Bank for International Settlements** also confirmed on July 13th that the Basel Committee on Banking Supervision had approved new standards to promote the building up of capital buffers that can be drawn down in times of stress, to strengthen the Basel 2 rules. And on July 16th the **Walker Review** of corporate governance recommended changes to the working of the boards of British financial institutions, including a boost for the role of non-executives in the risk and remuneration processes.

China's GDP grew by 7.9% in the second quarter of this year, having grown by 6.1% in the previous three-month period. A spokesman for the National Bureau of Statistics, said the economy "had stabilised with increasing positive changes". Investment in fixed assets was 33.5% higher in the first half of this year than a year earlier, reflecting the results of the government's massive fiscal stimulus. See article

Deeply indebted

America's Treasury released figures showing the **federal budget deficit** had exceeded $1 trillion for the first nine months of the fiscal year commencing October. This was twice the deficit for the whole of last year, and the largest deficit ever over a nine-month period.



General Motors, one of the world's biggest carmakers and now primarily owned by the governments of America, Canada and Ontario, emerged from bankruptcy on July 10th. The new company retains only four key brands—Chevrolet, Cadillac, Buick and GMC—and intends to reduce its American workforce from 91,000 at the end of last year to 64,000 by the end of 2009. The leaner company will operate 13 fewer American factories, and shrink its dealer network from 6,000 to 3,600 by the end of 2010.

Honda, the second-largest Japanese carmaker, announced plans to launch two petrol-electric hybrid cars next year. **Toyota** dominates the hybrid market and is itself reportedly considering expanding hybrid production to Britain in 2012.

Microsoft announced on July 13th that it would offer a free, web-based version of its popular Office suite of programs. The company also announced pricing plans for Azure, its cloud-computing platform, and opened it up to early adopters on July 14th at its Worldwide Partner Conference in New Orleans. The announcements marked the latest move in a series of attempts by Microsoft and **Google** to move onto

each other's turf. Earlier this month Google announced that it was building a PC operating system, and Microsoft challenged Google in May with the launch of Bing, an improved internet-search engine.

Intel, the world's biggest chipmaker, reported a net loss of $398m in the second quarter. This is the company's first loss in 22 years. The firm's bottom line suffered because it was required to set aside money to pay a $1.45 billion antitrust fine imposed on it by the European Union in May.

Beer goggles

Kirin and **Suntory**, two of Japan's biggest beer and beverage companies, announced on July 14th that they were talking about a merger. The combined firm would be one of the world's biggest drinks companies, with sales of ¥3.8 trillion ($41 billion). See article

CIT, a cash-strapped American commercial lender, fuelled speculation that it may have to go into bankruptcy when it said that it was unlikely to get a federal bail-out.

Phillips, a Dutch electronics company, announced a net profit of €44m ($60m) for the three months to June 30th, 94% lower than a year earlier.

Economist.com **OPINION**

KAL's cartoon

Jul 16th 2009
From The Economist print edition

Illustration by KAL

Economics

What went wrong with economics

Jul 16th 2009
From The Economist print edition

And how the discipline should change to avoid the mistakes of the past

Illustration by Jon Berkerly

OF ALL the economic bubbles that have been pricked, few have burst more spectacularly than the reputation of economics itself. A few years ago, the dismal science was being acclaimed as a way of explaining ever more forms of human behaviour, from drug-dealing to sumo-wrestling. Wall Street ransacked the best universities for game theorists and options modellers. And on the public stage, economists were seen as far more trustworthy than politicians. John McCain joked that Alan Greenspan, then chairman of the Federal Reserve, was so indispensable that if he died, the president should "prop him up and put a pair of dark glasses on him."

In the wake of the biggest economic calamity in 80 years that reputation has taken a beating. In the public mind an arrogant profession has been humbled. Though economists are still at the centre of the policy debate—think of Ben Bernanke or Larry Summers in America or Mervyn King in Britain—their pronouncements are viewed with more scepticism than before. The profession itself is suffering from guilt and rancour. In a recent lecture, Paul Krugman, winner of the Nobel prize in economics in 2008, argued that much of the past 30 years of macroeconomics was "spectacularly useless at best, and positively harmful at worst." Barry Eichengreen, a prominent American economic historian, says the crisis has "cast into doubt much of what we thought we knew about economics."

In its crudest form—the idea that economics as a whole is discredited—the current backlash has gone far too far. If ignorance allowed investors and politicians to exaggerate the virtues of economics, it now blinds them to its benefits. Economics is less a slavish creed than a prism through which to understand the world. It is a broad canon, stretching from theories to explain how prices are determined to how economies grow. Much of that body of knowledge has no link to the financial crisis and remains as useful as ever.

And if economics as a broad discipline deserves a robust defence, so does the free-market paradigm. Too many people, especially in Europe, equate mistakes made by economists with a failure of economic liberalism. Their logic seems to be that if economists got things wrong, then politicians will do better. That is a false—and dangerous—conclusion.

Rational fools

These important caveats, however, should not obscure the fact that two central parts of the discipline—macroeconomics and financial economics—are now, rightly, being severely re-examined (see article, article). There are three main critiques: that macro and financial economists helped cause the crisis, that they failed to spot it, and that they have no idea how to fix it.

The first charge is half right. Macroeconomists, especially within central banks, were too fixated on taming inflation and too cavalier about asset bubbles. Financial economists, meanwhile, formalised theories of the efficiency of markets, fuelling the notion that markets would regulate themselves and financial innovation was always beneficial. Wall Street's most esoteric instruments were built on these ideas.

But economists were hardly naive believers in market efficiency. Financial academics have spent much of the past 30 years poking holes in the "efficient market hypothesis". A recent ranking of academic economists was topped by Joseph Stiglitz and Andrei Shleifer, two prominent hole-pokers. A newly prominent field, behavioural economics, concentrates on the consequences of irrational actions.

So there were caveats aplenty. But as insights from academia arrived in the rough and tumble of Wall Street, such delicacies were put aside. And absurd assumptions were added. No economic theory suggests you should value mortgage derivatives on the basis that house prices would always rise. Finance professors are not to blame for this, but they might have shouted more loudly that their insights were being misused. Instead many cheered the party along (often from within banks). Put that together with the complacency of the macroeconomists and there were too few voices shouting stop.

Blindsided and divided

The charge that most economists failed to see the crisis coming also has merit. To be sure, some warned of trouble. The likes of Robert Shiller of Yale, Nouriel Roubini of New York University and the team at the Bank for International Settlements are now famous for their prescience. But most were blindsided. And even worrywarts who felt something was amiss had no idea of how bad the consequences would be.

That was partly to do with professional silos, which limited both the tools available and the imaginations of the practitioners. Few financial economists thought much about illiquidity or counterparty risk, for instance, because their standard models ignore it; and few worried about the effect on the overall economy of the markets for all asset classes seizing up simultaneously, since few believed that was possible.

Macroeconomists also had a blindspot: their standard models assumed that capital markets work perfectly. Their framework reflected an uneasy truce between the intellectual heirs of Keynes, who accept that economies can fall short of their potential, and purists who hold that supply must always equal demand. The models that epitomise this synthesis—the sort used in many central banks—incorporate imperfections in labour markets ("sticky" wages, for instance, which allow unemployment to rise), but make no room for such blemishes in finance. By assuming that capital markets worked perfectly, macroeconomists were largely able to ignore the economy's financial plumbing. But models that ignored finance had little chance of spotting a calamity that stemmed from it.

What about trying to fix it? Here the financial crisis has blown apart the fragile consensus between purists and Keynesians that monetary policy was the best way to smooth the business cycle. In many countries short-term interest rates are near zero and in a banking crisis monetary policy works less well. With their compromise tool useless, both sides have retreated to their roots, ignoring the other camp's ideas. Keynesians, such as Mr Krugman, have become uncritical supporters of fiscal stimulus. Purists are vocal opponents. To outsiders, the cacophony underlines the profession's uselessness.

Add these criticisms together and there is a clear case for reinvention, especially in macroeconomics. Just as the Depression spawned Keynesianism, and the 1970s stagflation fuelled a backlash, creative destruction is already under way. Central banks are busy bolting crude analyses of financial markets onto their workhorse models. Financial economists are studying the way that incentives can skew market efficiency. And today's dilemmas are prompting new research: which form of fiscal stimulus is most effective? How do you best loosen monetary policy when interest rates are at zero? And so on.

But a broader change in mindset is still needed. Economists need to reach out from their specialised silos: macroeconomists must understand finance, and finance professors need to think harder about the context within which markets work. And everybody needs to work harder on understanding asset bubbles

and what happens when they burst. For in the end economists are social scientists, trying to understand the real world. And the financial crisis has changed that world.

A general election called in Japan

Time's up for the LDP

Jul 16th 2009
From The Economist print edition

The next election marks the beginnings of a fundamental change in Japanese politics

AFP

AT HIS back Taro Aso had some disastrous results from Tokyo's metropolitan elections on July 12th, in which control of the capital passed from the Liberal Democratic Party (LDP) after 40 years. In front was a growing rebellion within the LDP against his leadership. So the prime minister pressed the nuclear button. This week he declared that he would dissolve the Diet, Japan's parliament, and lead the ruling coalition into a general election on August 30th.

Bitter colleagues accuse the prime minister of putting pride above the LDP's interests. They want a fresh face to contest the election; but even if they get one the party is almost certain to lose its post-war near-monopoly on power. Many Japanese people regard that prospect with either scepticism or anxiety, but it is the best thing that could happen to the country.

Mr Aso's standing is at rock-bottom. His tough talk comes across as arrogance, and it cannot hide his own lack of authority within the party's ranks. A bungled cabinet reshuffle is only the latest example of his impotence. He has failed to reassure voters about the economy, which is running fully 10% below its potential. Fears are growing over the state's ability to meet the welfare needs of an ageing, shrinking population.

For all his mistakes, Mr Aso is only a symptom of the party's steep decline. He is the fourth prime minister in as many years. The LDP has come to the end of the line. It has no ideas, no cohesion and is covered in sleaze. Fathers hand down seats like family heirlooms. Policy is secondary to plotting.

Japan's voters, who are guilty of having put up with this for far too long, at last seem to have had enough. Opinion polls suggest a landslide defeat for the LDP at the hands of the opposition Democratic Party of Japan (DPJ). Even if economic recovery now gathers pace, the LDP is unlikely to be spared. Having rotted from within, it does not deserve to be.

But many voters are sceptical that change is really coming. That is understandable. The 54-year-old LDP's obituary has been written many times, and the corpse has always revived. In 1993 it actually lost power, but within 11 months it was back. Again, before the 2005 election, it seemed to be in trouble, but the then prime minister, Junichiro Koizumi, somehow convinced voters that to vote for him was to vote against everything scuzzy in his own party. The showman's sleight of hand won the LDP coalition a stunning victory. However, today, given the government's dismal performance over the past four years, voters will surely not be dazzled by the same trick again. Besides, no one of anything like Mr Koizumi's calibre is in sight.

Those who believe change is coming are anxious—with good reason. Although the DPJ looks more like a real opposition than seemed possible a decade ago, it is an unlikely mix of socialists and former LDP hands without an identity or a coherent agenda. It has declared war on a discredited bureaucracy without acknowledging the need to harness bureaucratic energies to new policies. It slams Mr Aso's stimulus packages for adding to Japan's debt, yet its own proposals would probably add more.

Bring on confusion

And yet Japan needs the DPJ, for all its imperfections. That is because, even though the opposition cannot yet offer a convincing vision, it can at least offer the country two things that are long overdue.

The first is a fresh framework for government. The legacy of the LDP's one-party state is that policy and legislation pass in parallel through both government and party. Good policies (even the LDP had some) were often stymied by party barons with vested interests. Prime ministers since Mr Koizumi have tried to centralise authority within the cabinet office and pretty much failed. With its tighter party discipline, the DPJ can establish a mechanism that gives good policy a chance of becoming law.

The second thing Japan needs is for parties to alternate in power. That has never happened in Japanese post-war politics. The very fact of the DPJ's victory will create an incentive for parties to produce some attractive policies, in order to persuade the electorate to vote for them. That way, Japan might actually get some decent government.

If the DPJ, with its weak programme, comes to power, it may well not stay there for very long. And, as reformists leave the LDP in droves, Japanese politics will enter a difficult time. Uncertainty will spread to the country's foreign policy, including its alliance with the United States. But uncertainty beats the LDP's palsied monopoly.

The election campaign due to be launched next week is the first step on the path to renewal. And if it obliges voters to confront the shortcomings in their politics, that's just as well.

The war in Afghanistan

Hold your nerve

Jul 16th 2009
From The Economist print edition

It has been a bloody month in Afghanistan but America's allies, especially Britain, should not lose heart

EPA

AFGHANISTAN is said to be the graveyard of empires. The British army came to grief there in the 19th century, the Soviet one in the 20th. Such was Afghans' reputation for ferocity that Rudyard Kipling told those left wounded on Afghanistan's plains: "Jest roll to your rifle and blow out your brains." These days British soldiers are again dying in Afghanistan, along with Americans, Canadians and many others. The Taliban are resurgent. Each fighting season is bloodier than the last.

President Barack Obama is deploying an extra 20,000 troops there this year. But some allies are already on their way out. The Netherlands will withdraw fighting forces next year, followed by Canada in 2011. Now the public in Britain, which has the second-largest contingent in Afghanistan, is agonising over the country's role in the war after a dreadful month in Helmand (see article).

After eight years of disheartening warfare, it is tempting to see NATO's mission as a repeat of past misadventures in the Hindu Kush. The Soviets lost even though they had more troops than NATO has today, a more powerful Afghan army and were supported by a cadre of motivated Afghan communists. But such comparisons are wrong. Unlike the anti-Soviet mujahideen, who were backed by America, Saudi Arabia and Pakistan, the Taliban have no superpower sponsor. In the 1980s Soviet aircraft were shot down with American-made Stinger missiles; today NATO has mastery of the skies. The Taliban are a Pushtun faction, not a national movement; their insurgency is largely limited to the southern half of the country.

Afghans may feel anger over the death of civilians killed by foreign forces, frustration at the chaos and insecurity, and dismay at the corruption of President Hamid Karzai's government. But opinion polls say that most want Western troops to stay; they remember the misery of the civil war and the oppression of Taliban rule too well. They want the West to do a better job of securing the country.

The price of friendship

For America Afghanistan is a war of necessity; it is from there that Osama bin Laden ordered the attacks of September 11th 2001. For many European allies, though, it is less vital—a war of solidarity with America, a war of choice. Such operations quickly turn unpopular when they go badly, and governments tend to inflate their aims. Gordon Brown, the British prime minister, talks of promoting "an emerging democracy".

Critics say the effort is misconceived: the real danger is in Pakistan, where al-Qaeda's leaders are now hiding. But helping Pakistan fight Islamic militants will only be harder if the Taliban and al-Qaeda can claim victory in Afghanistan. Others say the West is being over-ambitious. It can never hope to create a stable democracy in Afghanistan; all it needs is a small contingent to protect Kabul, and some special forces and bombers to deal with any returning al-Qaeda fighters. But such a minimalist approach is what allowed the Taliban to regroup.

The cost to NATO countries is immediately apparent: tens of billions of dollars and the lives of more than 1,200 soldiers. The cost of leaving is harder to measure but is probably larger: the return of the Taliban to power; an Afghan civil war; the utter destabilisation of nuclear-armed Pakistan; the restoration of al-Qaeda's Afghan haven; the emboldening of every jihadist in the world; and the weakening of the West's friends.

America will naturally take on most of the task in Afghanistan. But allies are vital. They share the burden, they confer political legitimacy and their joint commitment makes it harder for too many to drop out. Yet some are expending a disproportionate amount of blood. Britain is among them, but it is not alone. As a share of their population Canada, Denmark and Estonia have suffered more military fatalities.

Friends and allies

Britain's ambition to be a global "force for good" comes at a cost. As America's best friend, with privileged access to intelligence, it feels compelled to take part in America's wars. As the most capable militarily of NATO's European members (together with France), it helps to rally others. But fighting in Afghanistan is not just about prestige. With its large population of Pakistani origin, it has much at stake in helping to maintain the stability of Afghanistan and Pakistan. London has been attacked by al-Qaeda more recently than New York.

So what should Britain do? To begin with, the government must act with conviction, rather than wish the problem away. It cannot be at war with a peacetime mind-set. As a share of the budget, defence spending has shrunk since 2001. The defence ministry is a parking place for weak ministers or a stepping-stone for strong ones. Priority should be given to manning fully the army's ranks, and probably expanding them. More must be done to provide helicopters, transport aircraft, drones and better-protected vehicles. This would wreck budgets and upset the navy and air force. So be it. Losing a war is even more demoralising than losing ships or jets. The government should have announced a Strategic Defence Review a long time ago, not delayed it until after the election.

At the very least Mr Brown should agree to the army's request for a permanent uplift of 2,000 troops for Helmand. Western forces are never going to garrison the whole province, let alone Afghanistan. But what they hold must be held securely. And above all, they must train and expand the Afghan army and police so they can gradually take over. That will not be cheap, but it is the best way to bring home Western troops.

In many ways, the push to pacify Afghanistan is only just starting, now that the war in Iraq is ending. America's marines launched a big operation in Helmand on July 2nd. Afghanistan's presidential elections take place next month. It will not be clear until the autumn, and probably not until late next year, whether Mr Obama's "surge" has worked.

This is not the time to lose heart. Security must be improved, economic activity encouraged, government strengthened and insurgents offered inducements to defect. But for those things to happen, the Taliban must see that the Afghan government and its foreign friends are winning, not losing.

Mark-to-market accounting

Divine intervention

Jul 16th 2009
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Accounting rules for financial firms are a mess. New proposals go some way to cleaning them up

Illustration by David Simonds

FOR the past two years accounting has been engulfed in a religious war. On one side are those who want loans, securities and other financial assets to be carried at market prices. On the other are managers, backed by many politicians and regulators, who would prefer assets to be carried at cost and written down only when they say losses are likely.

There are problems with both approaches. Fans of "marking to market" are accused of being zealots who forced banks and insurance firms to book exaggerated losses as prices fell, in turn pushing them into insolvency and sending the financial system spiralling towards hell. Those in the second camp, meanwhile, are accused of cooking the books before the crisis, and then bullying standards-setters to ease the rules once the scale of bad debts became clear. To make matters worse, a long series of fudges means firms' balance-sheets use a mix of both approaches. Different firms may hold identical assets at different prices, and recognise losses on them in several ways.

Into the mayhem has stepped the International Accounting Standards Board (IASB), which sets the rules in most of Europe and Asia and is eventually expected to have authority in America, too. Beaten up by furious politicians, and urged by investors to fight back, it has drafted new rules that should apply from the end of this year. The result is still a fudge, but a superior sort of fudge. With some tweaks it should deliver what both sides want: accounting that does not exacerbate the economic cycle, but which still allows investors to compare assets' market prices with managers' version of events.

Under the new proposals, there would be only two asset categories. Loans, and simple debt securities that are similar to loans, would be valued at their cost, provided banks can show they are being held for the long term—as most banks will try to. More complicated debt securities, including most of today's toxic detritus, as well as derivatives and equities, would be carried at market prices. This categorisation is pretty arbitrary (see article), but the practical result should be a drastic simplification of the rules and far better comparability between firms. Bank regulators are rejigging their rules, too. This should mean firms that report marked-to-market losses are not immediately forced into capital raising or fire-sales of assets.

Carrot and stick

IASB still needs to be on its guard. First, it must police the boundary between the two categories with a

big stick. However penitent today, managers will try to label opaque securities as loans to give themselves more discretion when valuing them. Anyone who doubts this should recall the frenzy of book-cooking after IASB modestly loosened the rules in October. Europe’s banks reclassified over half a trillion dollars of assets, boosting their 2008 profits by $29 billion in the process.

Second, IASB must ensure that investors can still find out the market price of any asset being carried at cost—a far better indicator of many assets’ toxicity than managers’ opinions. Banks today reveal this only in summary form. The disclosure needs to be fuller if investors are to be able to challenge managers’ valuations. Banks will complain about red tape, but if any information is important, it is surely this.

Finally, standards-setters must rebuild their independence after the political assault they have faced in both America and Europe. The best way to do this is to continue to merge their standards, including those for financial firms, into one global rulebook. That should help restore confidence by preventing regulatory arbitrage between jurisdictions and diluting the voices of powerful national lobbies. Investors need not trust in God, but they must be able to trust accounts.

Online gambling in Europe

Stacking the deck

Jul 16th 2009
From The Economist print edition

Prohibition of online gambling is driven by a desire to protect revenues, not consumers

Alamy

WHO says Europe cannot produce internet giants? In one area of online commerce, at least, its companies dominate the world. Betfair, an online-betting exchange based in London, has been called the eBay of sports betting (see article), and the vast majority of the websites that allow people to play poker and other games of chance or skill for real money are based in Europe.

In part, this is because that is where the market is: Europeans place some 40% of all online wagers. A bigger reason, however, is America's prohibition of online gambling. With its love of horse racing, sports and casinos, and its world-beating technology industry, America ought to be the natural home of this burgeoning field. But it has arrested industry entrepreneurs and ordered banks to halt payments to online-gambling firms. In June the European Commission grumbled that American restrictions on European online-gambling firms break World Trade Organisation rules.

Yet Europe itself is deeply divided when it comes to online gambling (see article). In theory there is a single market, but in practice only 13 of the European Union's 27 member states approve of online gambling. Seven countries restrict it to gambling monopolies owned or licensed by the state, and another seven have followed the Americans and attempted to outlaw it. Dutch banks face prosecution if they transfer money to online-gambling firms abroad, and Germany, Italy and Spain are trying to get internet service-providers to block access to gambling websites. That the European Commission is defending European firms' right to offer online gambling, even as some countries try to ban it, raises difficult questions about individual states' ability to override the single market in sensitive areas. But despite much huffing and puffing, the commission seems reluctant to raise the legal stakes.

Don't bet on prohibition

Politicians argue that prohibition is the best way to protect vulnerable consumers from a potentially addictive pastime. But kinks in the law expose their hypocrisy. In both America and Europe, local gambling monopolies are allowed to offer the same sorts of bets that are outlawed if placed with firms abroad. This suggests that the prohibitionist governments' main aim is to protect the revenue that they earn from their state-approved gambling monopolies.

The belief that they can do so by bullying banks and internet companies into stopping people from placing bets abroad seems naive. Gamblers know that they can get better odds when placing bets in more open markets where the house's take is usually 3-5% of the stake wagered. Traditional bookmakers or lotteries may keep as much as a quarter for themselves. Prohibition has not eliminated

online gambling in America: a steady stream of prosecutions attests to its continuing popularity. It has, however, driven the reputable internet gambling firms to friendlier shores and has pushed those Americans most determined to bet—the very people who are the most vulnerable to gambling's excesses—to place their wagers in the murkier bits of the internet.

Trying to stem this tide is pointless. Rather than criminalising gamblers for trying to get a better deal, governments would do far better to offer punters and online-gambling firms a safe, legal but regulated market—and gain some tax revenues to help plug their deficits at the same time.

Assisted suicide

Going gently

Jul 16th 2009
From The Economist print edition

The terminally ill should be helped to an easeful death, if they ask for it

Solo Syndication

ON JULY 10th two people died whose lives, though long, were shortened by design and with others' help. Sir Edward Downes, a British conductor, and his wife Joan had travelled to Switzerland, where the law on assisted suicide is the world's most liberal. He was 85, partly deaf and almost completely blind; she was 74 and had terminal cancer. Holding hands and watched by their son and daughter, they drank a lethal dose of barbiturates and died.

In most of the Western world, suicide is not a crime, but helping another to commit it is. But not all the incapacitated, or terminally ill, or permanently despairing are willing to wait for a natural death, or to take messy and uncertain measures to kill themselves without medical help. Increasingly, they travel to Switzerland, where assisting suicide is a crime only if it is done for gain (around 100 foreigners each year die at Dignitas, a suicide clinic in Zurich) and lobby their governments to change the law at home. In only a few places—Belgium, Luxembourg, the Netherlands, the American states of Oregon and Washington—have such efforts succeeded. Most countries muddle along, turning a blind eye to those determined and rich enough to travel to Switzerland. Dignitas—which gives its proceeds to charity—charges SFr10,000 ($9,300).

Kindness and cruelty

British police are investigating the deaths of Sir Edward and Lady Downes, as they have previously investigated the deaths of at least 100 such "suicide tourists". In no case have they prosecuted those who accompanied the suicides. But last week an amendment that would have guaranteed such people exemption from prosecution, subject to safeguards, was defeated in the House of Lords. The current law, said its defenders, showed a "stern face and a kind heart", deterring the avaricious from shuffling elderly relatives off to die before they wasted their assets on nursing-home fees, while refraining from vengeance on the broken-hearted bereaved.

Legal fudge is never desirable, and in this case it is unnecessary. It is perfectly possible to frame a law that allows suffering people who are close to death to die quickly and peacefully, if they wish, without declaring open season on old folk. The suicide-seeker declares he is not being pressured to kill himself; two doctors agree, and testify that he is terminally ill and of sound mind. A waiting period before lethal drugs are dispensed ensures that the desire for death is a settled one. Apart from Switzerland, those places that allow assisted suicide have similar safeguards. Such systems do not seem to lead to the normalisation of unnatural death, and thus a steadily rising number of suicides; rather, after an initial

surge, the number seeking help to die drops and then stays steady.

A law of this sort would have allowed Lady Downes to die as she wished in her own country. But it would not have covered Sir Edward, old, frail and soon to be bereaved one way or another—but not terminally ill. Nor would Daniel James, a 23-year-old Briton whose parents accompanied him to Dignitas last year, have come within its remit. He had been paralysed in a rugby accident, and wanted to die, but could not kill himself without help. Though severely disabled, he was not terminally ill and could have expected to live for many years.

There is a strong case for allowing people like Sir Edward and Mr James to be helped to die. Their lives were their own, and they wanted to end them. But there is too great a danger that if those who are not terminally ill are allowed an easy way out, greedy relations will put pressure on the elderly to choose to die. Such people should, therefore, be denied that right—however unkind that may seem. The terminally ill, however, should be offered the help they seek. To deny it to them is to add cruelty to misfortune.

Economist.com OPINION LETTERS

On American health care, Russia, food, private schools, Angela Merkel

Jul 16th 2009
From The Economist print edition

Curing the patient

SIR – You cited doctors' fees as a big contributing factor towards spiralling health-care costs in America ("Heading for the emergency room", June 27th). Doctors do not prescribe unnecessary tests out of greed; they do so because of the broken tort system. The fear of frivolous lawsuits plays a big part in motivating doctors to conduct "unnecessary" tests. Indeed, the single easiest way to reduce health-care costs is tort reform.

Jimmy Gardner
New York

SIR – You didn't mention administrative overheads, which make up about 30% of the cost of America's health-care system. Look into the front offices of doctors' premises and hospitals and you will see an army of clerks and accountants dealing with a multitude of insurance companies, each with different forms, different criteria and different payment schedules. If we were to standardise medical insurance forms, we would be able to absorb the cost of covering the uninsured.

Ken Moyle
Beaverton, Oregon

SIR – Some of the expense of health care derives from Americans' diet and sedentary lifestyle. We have the highest percentage of overweight and obese patients in the industrialised world. One-third of Americans are obese; that is 50% more than the British, 100% more than the Germans and 250% more than the French. The cost of treating obese patients rises as their body mass index increases.

Obesity lessens life expectancy more than smoking. I would like to see Europe's health-care costs with the same levels of obesity.

Dr Arturo Bonnin
Dayton, Ohio

SIR –The number of those without health insurance is overstated. Around 20m of the 47m uninsured are college students or wealthy folk who choose not to pay for it. Another 11m are already eligible for Medicaid but haven't signed up. A further 10m aren't even American citizens. That leaves 6m-10m people who are truly needy, not including those in prison who generally receive better medical care than poor law-abiding citizens.

Gail Lightfoot
Arroyo Grande, California

SIR – Your leader on health care was titled "This is going to hurt" (June 27th). Some 60% of personal bankruptcies in 2007 were rooted in health problems, and 78% of those people had health insurance. It already hurts.

Neel Blair
Seattle

SIR – I choked on my coffee when I saw you refer to hospitals and doctors as "price-fixing cabals". I have practised medicine for 21 years and have never had my full fee for a procedure reimbursed by a third party. The fees are fixed by large insurers and Medicare, and all too often those fees no longer cover the expense of providing the service. Antitrust regulations for physicians are already far more stringent than those applied to other professions in America.

Dr Matthew Wood
Bristol, Tennessee

Russia and the world

SIR – It is a shame that you continue to see Russia in such a negative light ("In search of détente, once again", July 4th). It must also be baffling for your readers. Rather than being a country intent on reviving the hostility of the cold war, Russia's government plays a positive role in world affairs.

There are, of course, differences between Russia and America. But the discussions and agreements on reducing nuclear weapons and on non-proliferation showed two nations committed to working together to build a safer and more secure world. The unprecedented agreement to enable military hardware to be transported to Afghanistan, across Russian territory, also highlighted a new spirit of co-operation. This will boost the coalition's efforts at a critical time.

The America-Russia summit highlighted the determination of our respective leaders to forge a new relationship based on goodwill, mutual respect and an honest understanding of each other's interests. It is time *The Economist* caught up.

Yury Fedotov
Ambassador
Embassy of the Russian Federation
London

SIR – You attributed Russia's dismal investment climate to legal caprice and unpredictable courts ("Courting disaster", July 4th). This is difficult to square with the World Bank's ease of doing business survey that you quote. The survey's "enforcing contracts" category, which measures the efficiency of a judicial system in resolving commercial disputes, places Russia in joint 18th with China, ahead of Britain (24th). Brazil and India are ranked 100th and 180th respectively. Perhaps your final remark is more apposite; "the truth is more complicated".

Vladimir Meerovich
London

Back to the land

* SIR - Your article outlined the causes and consequences of the food crisis but needed to identify solutions ("Whatever happened to the food crisis?", July 4th). Increasing production in developing countries is essential for poverty reduction and global food security. Yet farmers that ActionAid works with are unable to respond to rising prices. As you point out, production in the least developed countries is failing. Farmers blame two factors: impact of an already changing climate and a lack of investment in seeds, irrigation and other inputs. A relatively small increase in G8 aid to food and farming to $23 billion annually would help farmers to feed their families and grow their way out of poverty. Progress on significantly reducing greenhouse gas emissions would give the next generation the same opportunity.

Meredith Alexander
Head of trade and corporates
ActionAid UK
London

The chosen few

SIR – Your leader on education in America and Britain ended by pairing Winchester and Amherst as private schools ("Learning lessons from private schools", July 4th). Winchester is a school, but Amherst is an institution of higher education. Although I am an alumnus of Williams College, Amherst's arch-rival, I want to add my voice to those of the irate Amherst graduates who no doubt have castigated you for your error.

Seymour Becker

New York

SIR – Surely Britain’s independent schools are educating the wrong people. The children of the wealthy do well in any educational environment. It is the offspring of the poor who all too often fail and could benefit most from the teaching and standard of care in the private sector.

The state should fund boarding places for young people identified by social services as having severe problems, who could then be diverted into professions such as the law or investment banking. I am confident that the heads of schools such as Eton and Winchester would welcome the challenge of admitting, say, 20% of their intake from such backgrounds.

Robert Walls
Camberley, Surrey

SIR – Events held by Oxford and Cambridge have so emphasised their focus on state-school applications that my daughter’s classmates at her fee-paying school are looking elsewhere. The state school her siblings attend has directed no less than three teachers to focus on Oxbridge applications. They recognise there is a more open door, and I suspect we will observe quite a rapid change in the private-state ratio in the coming years.

Ged Parker
Washington, Tyne and Wear

* SIR - You are right to point out that the future of elite schools depends on the attitude of elite universities. When parents with disposable income can buy advantage for their children in this way they will do so—irrespective of the educational record of the state sector. For this reason the huge bias in favour of pupils from fee-paying schools revealed year-on-year in the Oxbridge admission statistics should be regarded as matter of national concern.

Martyn Sloman
Melton Constable, Norfolk

Barracking Obama

SIR – Your leader on Angela Merkel called on her and all of Europe “to shift away from high taxes, generous and wasteful welfare states, and, most of all, overly regulated and inflexible product and labour markets” (“The mystery of Mrs Merkel”, June 27th). I have but one request: would you please admonish Barack Obama for the same things.

John Toohey
San Antonio

SIR – Could you enlighten me as to where I might find “flashily intellectual” European leaders?

Heinz Kestermann
Sydney

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* Letter appears online only

British forces in Afghanistan

And the soldier home from the hill

Jul 16th 2009 | NAD ALI
From The Economist print edition

The British public is honouring its fallen troops as never before. But for how long will it support the war in Afghanistan?

AP

FIRST came the tolling bells of St Bartholomew's church. Then the traffic disappeared and the throng on both sides of the road fell silent. The order for the members of the Royal British Legion to dip their standards was shouted out. The undertaker, in a black top hat, began his slow march, followed by eight gleaming hearses, each carrying the coffin of a fallen British soldier wrapped in the Union Flag. Their passage was punctuated by faint thuds of flowers being thrown on the bonnets. Hesitantly at first, then vigorously, a ripple of applause rose from the onlookers. Finally came the sound of muffled sobbing.

The village of Wootton Bassett in Wiltshire, close to RAF Lyneham, has honoured British servicemen killed in war dozens of times since the first impromptu show of respect in 2007. But never has there been a public salute such as the gathering on July 14th. It became a national day of mourning, broadcast live on television, with thousands of people from across the country—veterans of wars past, and citizens who have never known war—honouring the dead soldiers. It was not a day for politics. But there was a clear sense of anger with the government, whether for sending boys to die in a distant war, or for trying to fight that war on the cheap, without the right manpower or equipment. "I'm here to respect them young lads that have lost their lives over what I consider an unnecessary war," said a former soldier wearing three campaign medals. "They [the Afghans] thrashed the Russians, and they're going to thrash us again."

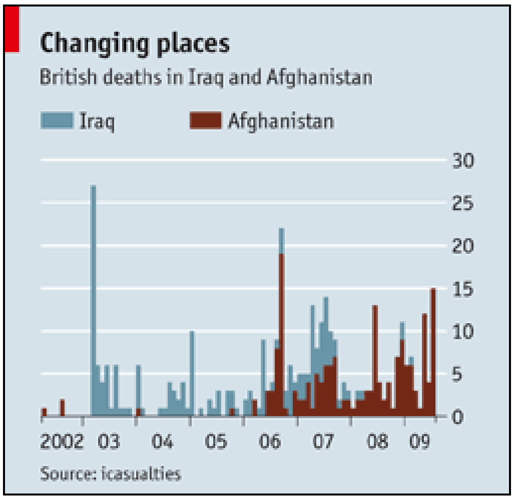
The British public has long been accustomed to the deaths in action of its servicemen. Almost every year since 1945 has seen military fatalities in some corner of the world. Indeed, Britain prides itself on being a nation of fine soldiers. It invaded Iraq with America, and provides the second-largest contingent of forces to the NATO-led International Security Assistance Force (ISAF) in Afghanistan. But something is shifting in the attitude of the British public towards the war in Afghanistan, and it will be watched closely by America and other allies. President Barack Obama has been quick to praise the "extraordinary" work of British troops, recognising that he needs to help keep them in the fight.

It has been a particularly bloody month in Helmand province, where British troops have been slugging it out with the Taliban for three years for limited gains. Fifteen soldiers have died so far this month; more have now lost their lives in Afghanistan than in Iraq. The eight who arrived at Wootton Bassett died in the space of 24 hours. Five were killed in a double bombing in Sang in that all but put their platoon out of action. The rest died in the district of Nad Ali, where the British forces are trying to push the Taliban out in Operation Panchai Palang, or Panther's Claw. The operation has been making slow progress through a maze of irrigation canals—a terrain as hard as the *bocage* of Normandy in the second world war, mixed with Iraq-like fighting around civilian compounds and countless home-made bombs. To a growing number

of critics, it is the British who are caught in the Taliban's claws.

The war in Afghanistan has, until recently, had an oddly low political profile in Britain. One reason is that it was long overshadowed by the conflict in Iraq. With the withdrawal of Britain's last combat troops from Basra, that is no longer the case. The other reason is that, unlike the conflict in Iraq, the Afghan war has commanded broad political support. Whereas the Liberal Democrats, the country's third party, opposed Britain's participation in the invasion of Iraq, all the main parties have supported the country's involvement in Afghanistan since the outset. At least, they have done so until now.

Ministers against generals

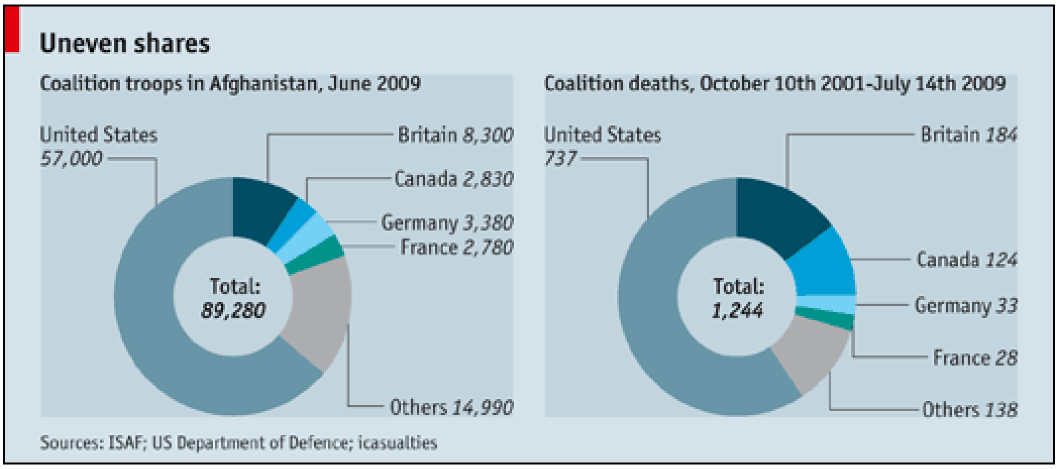


The cross-party consensus on Afghanistan is under more strain than ever before. Both the Tories and the Lib Dems still say they back the deployment, but they attack the government's perceived lack of strategy and its parsimony towards the armed forces. Liam Fox, the Tory shadow defence secretary, has accused the government of "the ultimate dereliction of duty". The Tories have concentrated their fire on the shortfall in the helicopters available to British forces—though the criticism is undermined by their reluctance to promise extra defence spending if they win the election due by next year. Nick Clegg, the leader of the Lib Dems, has been sharper: he talks about soldiers' lives being "thrown away", describing the mission in Afghanistan as "over-ambitious in aim and under-resourced in practice".

Yet the most important divide may not be between political parties but between government ministers and military commanders. Gordon Brown's ill-judged appointment of Des Browne in 2006 as defence secretary, doubling the next year as Scottish secretary, alienated some of the top brass. Confidence has hardly been increased by the loss of his successor, the well-liked John Hutton, during last month's crisis over the future of Mr Brown, and the promotion of the junior defence minister, Bob Ainsworth, to the main job as the least bad option.

The prime minister now stands accused by many generals, more explicitly than is customary, of skimping on the men and kit needed for the Afghan campaign. In an interview this week in Helmand General Sir Richard Dannatt, the outgoing head of the army, noted that he was flying in an American helicopter because a British one was not available. He had asked in public for a reinforcement of 2,000 troops (and more in private), but received the promise of only a temporary boost of 700 soldiers, amid resistance from the Treasury and the Foreign Office. All this feeds the generals' belief that Mr Brown does not much care for the armed forces. One general says: "Tony Blair did not understand us. Gordon Brown does not like us."

This vocal disgruntlement is one factor that may sway public opinion about the war. Polls have offered wildly varying impressions of the support it enjoys among the electorate. One conducted this week, for the BBC and the *Guardian* newspaper, found that roughly equal proportions declared themselves for and against the war—and that support for it was actually higher now than it had been in 2006. Britain's precarious fiscal position will make a difference; voters may be less inclined to back expensive military adventures as state expenditure at home is cut, as it soon must be. And, above all, the rising level of fatalities may tilt sentiment, and embolden politicians, against the war.



Matters are only aggravated by the fact that the service chiefs are not just fighting the war in Afghanistan, but are also scrapping among themselves over scarce funds and the future of defence policy. On current plans, the bill for military equipment will amount to billions more than the defence budget provides for, and nobody expects more money. Today's wars are being fought primarily on land, but the big money is being spent mostly on fighter jets, ships and submarines. For some officials in Downing Street, the army's request for more resources is a ploy to shore up its position relative to the other services—a policy of "use it or lose it".

Such suspicions are not without foundation. Consultations have started for a Strategic Defence Review, the first since the one overseen by George Robertson in 1998, that both Labour and the Tories promise to set up after the next general election. General Sir David Richards, the incoming army chief, says there are two contending visions: "fortress Britain", in which the country equips itself for a conventional all-out war against, say, Russia; and "asymmetric" warfare, in which Britain continues to involve itself in messy counter-insurgency campaigns. In his view, Britain needs to concentrate on asymmetry—by implication, cutting big programmes for planes and ships. The "risk" it would take in high-end warfare would be mitigated by NATO's protection.

Bloodied in the green zone

Such debates seem distant from the men of the 1st battalion of the Welsh Guards, pushing grittily along the Shamalan canal. The idea behind Operation Panther's Claw is to extend control of the populous, irrigated "green zone" by linking up the capital of Helmand, Lashkar Gah, with Gereshk, on the main ring road. The canal would become the new defensive line, keeping the Taliban out in the west while protecting the population on the other side. By controlling the bridges over the canal, and by using biometric technology, they will keep a close watch on those crossing in and out. For now, though, the British troops are under fire from both sides of the canal. Their only supply route is the narrow road along it, where the Taliban have been planting as many bombs as they can muster. Attacks on the British positions at dawn and dusk are routine; one Welsh Guards company was attacked 15 times in a day.

Progress has been slow, partly because the troops are being methodical in holding on to their gains and partly because they are meeting strong resistance from the Taliban. The British have advanced only two kilometres in two months of fighting. It is a tough, frustrating and bloody business. One of several fatalities in the operation was the battalion's commander, Lieutenant-Colonel Rupert Thorneloe. The Ministry of Defence has resorted to boasting about the number of Taliban it has killed in the operation, nearly 200, even though senior officers know that such "body counts" are irrelevant.

In parallel, American marines are making a big push to extend control of areas farther south. The American overall commander, General Stanley McChrystal, has urged his troops to minimise civilian deaths, even at risk to themselves. It is easier said than done, as Major Giles Harris, a company commander, explained. "When we meet the bad guys, we win," he said. But protecting civilians was "a continual challenge". "It is the discipline required not to take the gloves off. You are asking my guardsman not to empty the magazine of his weapon into the compound wall from which he is being shot at."

All along the canal, a frequent refrain from soldiers is: "Do you think we are winning?" The more pertinent question, perhaps, is why the area was lost in the first place. Until 2008 Nad Ali had been held by pro-government militias financed, in large part, by

the drugs trade. In 2007, when the Taliban took root around the town of Babaji, they were evicted by British forces helped by the militias. The next year, however, Toor Jan, the leader of the biggest militia, was killed, security collapsed and the Taliban took over. One factor was the influx of Taliban fighters pushed out of the Garmser district, where American marines were clearing insurgents. Another was that Nad Ali, as a government-held area, was the only part of Helmand where large-scale eradication of opium poppies took place, helping to turn the population against the government. By late 2008 Nad Ali became known as a place of tough, pure Taliban justice, in contrast with the corrupt ways of Toor Jan's henchmen.

Haji Meshan Khail, a tribal elder from the district, says: "Before the British soldiers came to Helmand we had very good security and peace. Now we are escaping from one place to another because there is a lot of fighting and bombing. People in the Nad Ali district are tired of ISAF and Taliban. They don't like either of them. But they think that Taliban is better. When British soldiers capture a place they start checking all the houses and arrest the civilians without any reason."

The story of Nad Ali illustrates the unhappy experience in Helmand. British forces never really wanted to deploy there; they would rather have gone to Kandahar, the biggest city in the south, but it was allocated to the Canadians. British paratroopers arrived in Helmand in the spring of 2006, with the then defence secretary, John Reid, declaring incautiously that he would be "perfectly happy to leave in three years' time without firing one shot". The British had planned to concentrate on creating a "development zone" between Lashkar Gah and Gereshk. But under pressure from the government to stop outlying towns from falling to the Taliban, the force was parcelled out into "platoon houses" that came under severe attack. In their first six-month deployment, the paras fired about half a million rounds.

Subsequent British contingents were similarly stretched out. One aim was to clear the road to the Kajaki dam to allow the refurbishment of a hydroelectric plant. Another was to retake the town of Musa Qala, abandoned by the British in 2006 despite American protests. British tactics changed with each six-month rotation of troops. One especially damaging practice was "mowing the lawn"—raiding areas repeatedly to clear out insurgents without holding the ground, exposing anyone friendly to the British to grisly retribution. Whereas the American army and marines drew up a new manual on counter-insurgency in 2006, the British have yet to revise their doctrine. They rely heavily on American thinking, without American resources.

Eyevine

Underresourced, underequipped and fired at from both sides

There were several reasons why British commanders asked for more troops last year: to "thicken" the forces available to hold central Helmand, to deal more efficiently with bombs and to release men to train the Afghan police, widely regarded as corrupt and predatory. Demand for helicopters has always outstripped the (growing) supply. Yet the British debate over military resources misses important points: heavy mine-resistant vehicles are unable to move off the roads and surprise the enemy; helicopters are vulnerable and must stay away from high-threat areas; and Britain will never have enough troops to secure Helmand province. Counter-insurgency is about engaging local populations, and that cannot be done from the air or from inside a Mastiff armoured vehicle.

In any case, the question of whether Britain should send a few hundred more troops and a dozen extra helicopters, useful as they may be, is marginal compared with the military power that the Americans are bringing into Helmand this year: 10,000 marines (more than the total number of British, who are nominally in charge) and 100 or more helicopters. But even these reinforcements are not enough.

More Afghans, not more Brits

General McChrystal privately reckons he needs about 400,000 Afghan soldiers and police, double the number now envisaged, though the proportions of each are subject to debate. In Helmand there are just 3,000 Afghan soldiers compared with around 20,000 foreign troops. "I need ten Afghans for every British soldier," says one British commander. Worse, Afghan battalions are exhausted. They do not rotate out of the front line: soldiers fight without a break for the three years they are enlisted. Afghanistan cannot afford the army it has, let alone a bigger one. Expanding Afghan forces will cost donor countries several billion dollars a year indefinitely. But trying to garrison Afghanistan with foreign troops would be even more expensive.

The country needs a lot more than just military force, above all a legitimate and functioning government and a process to bring Taliban fighters and commanders back into the fold. For all of this, creating strong Afghan forces is the prerequisite. Without them, British soldiers will continue to die, and the people of Wootton Bassett will continue to line the road—until the day, that is, when the British public has had enough and demands that the troops come home. A retreat without securing some sort of success would be the cruellest blow for the men on the ground.

Correction: Uighurs

Jul 16th 2009
From The Economist print edition

In last week’s briefing on the Uighurs, we wrote that four Uighurs from Guantánamo Bay had been resettled in the Bahamas. We were wrong; they have gone to Bermuda. Sorry. This has been corrected online.

The Supreme Court

Empathy v law

Jul 16th 2009 | WASHINGTON, DC
From The Economist print edition

Which Sonia Sotomayor is the Senate about to confirm?

Bloomberg

FEW people recognised the white-haired protester, but everyone knew her story. Norma McCorvey is better known as "Jane Roe", the pregnant litigant behind *Roe v Wade*, the 1973 Supreme Court decision that legalised abortion. Ms McCorvey is now passionately pro-life. On July 13th, she was briefly arrested for disrupting the first day of Sonia Sotomayor's Senate confirmation hearings by hollering for *Roe v Wade* to be overturned.

That is unlikely to happen any time soon, if ever. If Barack Obama thought Ms Sotomayor would vote to overturn *Roe*, he would not have nominated her to the Supreme Court. Granted, presidents sometimes make mistakes, and Ms Sotomayor has been predictably guarded about her views. Asked privately last month if she thought the unborn had rights, she reportedly said she had never thought about it.

To many conservatives, *Roe v Wade* was a watershed. The constitution does not mention abortion. Yet the Supreme Court read between the lines and found a right to choose one, thereby seizing control of abortion policy from elected state legislators. That fuelled the culture war, for two reasons. First, a large minority of Americans think abortion is murder. Second, many think judges should not substitute their personal preferences for the law. And that is the issue that has so far dominated Ms Sotomayor's confirmation hearings.

Republicans complain that, in a series of speeches, Ms Sotomayor has suggested that a judge may be guided by something other than the facts of the case and the relevant American law. For example, she has said it is appropriate to consider foreign law when interpreting the American constitution. Since there are rather a lot of foreign laws, this sounds like a licence to pick and choose whatever supports the judge's preferred outcome.

Equally worrying to conservatives, Ms Sotomayor has said that sex and ethnicity may influence a judge's decisions. In 2001, for example, she noted that former Supreme Court justice Sandra Day O'Connor thought that "a wise old man and a wise old woman will reach the same conclusion in deciding cases." Ms Sotomayor said: "I am…not so sure I agree with [this] statement…I would hope that a wise Latina woman with the richness of her experiences would more often than not reach a better conclusion than a white male."

Ms Sotomayor spent most of this week repudiating this sentiment. “The task of a judge is not to make the law. It is to apply the law,” she said. As a lower-court judge for 17 years, she said, she has faithfully upheld the law and precedents. Asked whether she agreed with Barack Obama that judges should rely on “empathy”, she said: “We apply law to facts. We don’t apply feelings to facts.” She said the “wise Latina” quote was misunderstood.

Republicans do not believe her. Her rulings as a judge have been “generally speaking left of centre, but within the mainstream,” said Lindsey Graham, a Republican senator from South Carolina, but her speeches “just blow me away”. Mischievously, Mr Graham asked her if she could recite her “wise Latina” quote from memory. Of course, she did not want to repeat it on television. Mr Graham, who is white, observed that if he had said white males make better senators, it would have ended his career, and rightly so.

“The Framers created a written constitution to make sure our constitutional rights were fixed and certain,” said John Cornyn, a senator from Texas. “The role of judges was intended to be modest,” he said, but over time “the Supreme Court has invented new rights not clearly rooted in any constitutional text.” For example, he said, it has micromanaged the death penalty, invented new rules governing everything from sex to punitive damages and even changed the rules of golf. Democrats retort that Ms Sotomayor’s long and modest record as a judge is more important than her speeches. Republicans are not reassured. As a lower-court judge, she was bound by Supreme Court precedent. Once on the Supreme Court, she will not be.

Ms Sotomayor’s confirmation is in little doubt. Republicans have only 40 out of 100 seats in the Senate, so they cannot block her. But the hearings still matter. Both parties think they can gain a political advantage from them. Republicans hope to win votes by highlighting areas where Democratic orthodoxy strikes most Americans as unfair.

For example, only 9% of Americans think that race should ever be a factor in deciding who gets promoted for a job, according to a poll by YouGov for *The Economist*, while 85% think it should not. Hence the Republicans’ decision to call as witnesses this week some firefighters who were denied promotion because of their skin colour. They did well on a test, but none of their black colleagues did, so the city that employed them threw out the test and promoted no one. Ms Sotomayor ruled that that was fine; the Supreme Court recently reversed her decision.

Democrats hope to win votes because Ms Sotomayor would be the first Latina on the Supreme Court. Hispanics are a large and swelling part of the electorate. They cast 9% of the votes in last year’s presidential contest. And their votes are up for grabs. Republican attacks on her can easily be portrayed as white guys in suits trying to keep a qualified Latina down. So the Republicans are treading carefully.

Meanwhile Ms Sotomayor is acquitting herself well enough. She does not dazzle, but she knows her stuff and has made no mistakes so far. She answers questions slowly, as if making sure that nothing informative passes her lips. Asked about her legal philosophy, she says she doesn’t like labels. Asked if the Supreme Court overstepped its authority in a property-rights case, she said the Court thought not.

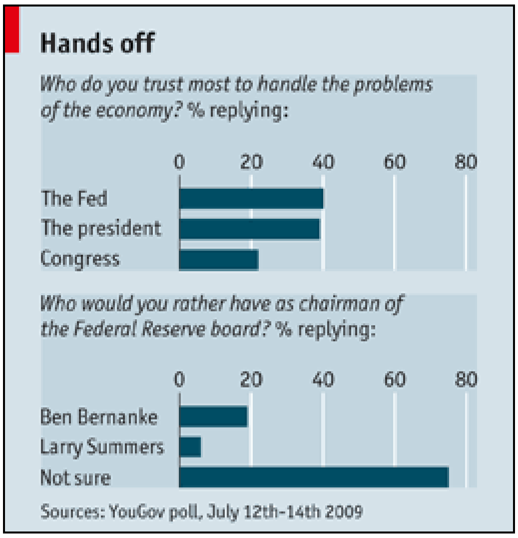
According to YouGov some 41% think Ms Sotomayor should be confirmed, while 29% oppose and 30% are unsure. But the only voters she needs to worry about are the 100 in the Senate. And, as Mr Graham observed, unless she has “a complete meltdown”, she will be confirmed.

Oversight of the Federal Reserve

Unwelcome attention

Jul 16th 2009 | WASHINGTON, DC
From The Economist print edition

Congress threatens the central bank's independence



WHEN Ron Paul ran for president in 2007, he was gratified to hear students at one of his rallies start chanting "End the Fed", while setting dollar bills alight. Though the Texas congressman's pursuit of the White House ended in failure, his campaign against the central bank is gaining some adherents.

Mr Paul has introduced a bill that would give the Government Accountability Office (GAO), the non-partisan investigative arm of Congress, the right to inspect the Federal Reserve, including its conduct of monetary policy, its lending and its relations with foreign central banks, all of which are now off-limits. Sixty percent of the members of the House of Representatives have signed on as co-sponsors.

The bill's proponents defend it as nothing more than a push for transparency and accountability. But that is disingenuous; Mr Paul has long campaigned for the Fed's abolition. Short of that, the danger is that Congress would use GAO audits to hammer the Fed for doing unpopular things—tightening monetary policy, for instance. The bill thus weakens the Fed's cherished and vital independence, and its vice-chairman has warned that it could unsettle the markets and so lead to higher interest rates.

Since 2008 the Fed has lent to firms previously ineligible for its credit and bought up government bonds with newly printed money. Although almost certainly saving the economy from an even worse mess than it is now in, those actions have reawakened a long-dormant streak of scepticism towards the central bank. Americans and Congress are upset about reckless bankers, failed regulators and bail-outs. The Fed makes a proxy for all three.

The unease cuts across party lines. Mr Paul is a conservative Republican, but a third of his co-sponsors are Democrats. The sponsor of the Senate's version of the bill is the only socialist in Congress, Bernie Sanders of Vermont. Republicans fiercely oppose Barack Obama's proposal that the Fed should oversee the largest, most systemically important financial firms; they think it would compromise the Fed's attention to low inflation. Democrats who shrink from criticising their own president can attack the Fed over bank bail-outs.

Mr Paul's bill is unlikely to become law. The Democratic leadership does not support it and few senators have signed on. But it may affect Congress's appetite for expanding the Fed's powers as much as Mr Obama would like. The Fed could face restrictions on its emergency lending authority or be required to disclose more about its lending operations. (It has already boosted disclosure and allowed more GAO scrutiny.) Less likely, but more serious, its structure could be revamped: the role of private bankers may be reduced or reserve bank presidents may need Senate confirmation.

Whatever the outcome, the increased scrutiny has unpleasant implications for the Fed, argues Tom Gallagher of ISI Group, a broking firm. It suggests diminished, though still favourable, odds that Ben Bernanke will be reappointed as the Fed's chairman when his term ends on January 31st next year; greater caution by the Fed in using its balance-sheet to prop up the financial system; and more doubt about whether the Fed will be able to tighten monetary policy soon enough in the face of political resistance.

Mr Bernanke, keen to show sympathy for ordinary people's worries, will hold a televised "town hall"

meeting on July 26th in Kansas City. He will need all the goodwill he can get. Mr Paul has turned his campaign's "End the Fed" chant into the title of a book to be published in September. "The Federal Reserve should be abolished because it is immoral, unconstitutional, impractical, promotes bad economic policy and undermines liberty," he writes. His sometimes rambling polemic is unlikely to win many adherents on Capitol Hill. But if a decent share of Mr Paul's donors, who he claims number more than 300,000, buy a copy, it will become a bestseller.

To hear an interview wtih Ron Paul, go to Economist.com/audiovideo/unitedstates

Congress's new health-care plan

Soak the rich

Jul 16th 2009 | NEW YORK
From The Economist print edition

The House of Representatives turns its back on common sense

Illustration by Claudio Munoz

BARACK OBAMA has been pushing leaders in both chambers of Congress to produce health-care bills before the August recess, with an eye to enacting reform before the end of the year. After weeks of wrangling among the three different House committees with partial jurisdiction over the matter, the House has pipped the Senate to the post. On July 14th Nancy Pelosi, the speaker, unveiled a grand strategy for health reform that is so far to the left of American political discourse that even moderate Democrats in the Senate (never mind the incensed and irrelevant House Republicans) held their noses.

Put simply, the House bill hopes to achieve near-universal health coverage by soaking the rich. Unlike some earlier Senate drafts, which either did not cover most of the nearly 50m uninsured or whose costs were reckoned to be a whopping $1.5 trillion or so, this new effort is a serious runner. According to a preliminary judgment by the Congressional Budget Office (CBO), which "scores" such plans, the House bill is likely to cost about $1 trillion and cover some two-thirds of the uninsured. That is a good proportion, as many of the remainder are illegal immigrants who have no chance of getting subsidised coverage under any reform.

And the plan does this in apparently "budget neutral" fashion, a requirement that everyone in Washington agrees on. The snag? Rather than finance this large expansion of coverage through savings found within the health system, as Mr Obama had prudently requested, the Democratic party's leadership plans to pay for it by imposing an ill-advised tax on business and a steep "surcharge" on the wealthy. Companies with payrolls bigger than $250,000 per year must provide health cover for employees or face a hefty fine. The bill also plans to raise over $500 billion by increasing taxes on those making over $350,000 a year by up to 5.4%.

By embracing these two taxes, the House rejected the financing method recommended by most economists (and by this newspaper). The tax preference given to health insurance provided by employers (over, say, the coverage bought by the self-employed) is a market distortion that costs the exchequer some $250 billion a year. Abolishing or even merely restricting that policy could pay for much or all of the cost of universal coverage, as well as boosting labour mobility and making the cost of coverage more transparent to consumers. This virtuous policy never had a chance in the House, because union members get some of the best insurance packages.

It may yet surface in the Senate, however, where two committees are working on reform, each with its own bill. The health committee has produced its version, but the finance committee, which has its own plan, has got bogged down on the crucial question of how to pay for reform. The Senate may curtail or cancel its August recess to complete this work.

What would a final Senate bill look like? Senate Democrats are unlikely to favour the House plan for tax increases. That would leave a hole, so the sensible, if unsexy, proposal for modifying the tax exclusion on employer-provided care could live to fight another day. Fat cats—and economists—can perhaps rest easy.

Investigating torture

Looking back in anger

Jul 16th 2009 | WASHINGTON, DC
From The Economist print edition

The past will not go away

AP

They won't let him live happily ever after

EVEN for a president as avowedly forward-looking as Barack Obama, the clamour to revisit the darker chapters of George Bush's war on terror is proving irresistible. Congressional Democrats and civil-liberties campaigners have long craved an inquiry to finger the culprits of torture and other alleged crimes. Mr Obama, keen to avoid the partisan warfare that bogged down his two predecessors, has demurred.

That may be changing. It was revealed on July 11th that Eric Holder, the attorney general, is minded to appoint a prosecutor to investigate whether CIA interrogators tortured suspected terrorists during the Bush years. Revelations contained in a classified report by the CIA's inspector general, written in 2004, are said to have swayed the previously reluctant attorney general. Many Republicans argue that an investigation would leave the CIA feeling betrayed and hamstrung in its pursuit of terrorists. The scope of Mr Holder's inquiry will probably be limited to whether intelligence officials went beyond the rules set by Mr Bush's own justice department which allowed some forms of "enhanced interrogation", including waterboarding, or anticipated them before they were actually made. But many people on the political left want a much broader Congressional probe that would also grill the politicians who made those rules.

The dredging-up of the recent past does not end with Mr Holder's investigation, which has yet to be formally announced. Mr Obama has also asked his national-security staff to look into the apparent slaughter of Taliban prisoners by local forces allied to America shortly after the invasion of Afghanistan in 2001. A formal inquiry may follow. And Dick Cheney, the former vice-president, is under pressure after it was revealed that the CIA withheld information from Congress about counterterror operations, supposedly at his request. The revelation, which if true could constitute a breach of the National Security Act, came from a leaked briefing to Congress by Leon Panetta, the head of the CIA. Mr Panetta has ended the operations in question but the demand for some kind of Congressional investigation into CIA secrecy has not abated.

Mr Obama's dilemma reflects the tension between two of his political traits: his expressed desire to transcend the partisan rancour of the baby-boom generation of politicians that so disfigured the Clinton and Bush presidencies, and his reluctance to face down his own party. The determination of Congressional Democrats to claim scalps from the Bush administration remains visceral. The sops being thrown their way, such as Mr Holder's investigation, may calm their ire for a while. But they may also stoke it. Busy enough with the economy and his health-care reform package, Mr Obama can do without the messy saga that an exhumation of Mr Bush's counter-terror policies could easily become.

Neither are Democratic hands entirely spotless. Nancy Pelosi, the speaker of the House of Representatives, was reportedly briefed on the CIA's plans for waterboarding and other controversial techniques in 2002, and raised no qualms. She recently claimed that she was told only that these methods were within the law, not that they would actually be used. A broad inquiry into the CIA may expose material that lend credibility to her accusations of deceit on the part of its officials; but it also risks keeping attention focused on the question of how much she knew and when—and why she did not ask more questions or kick up more of a fuss.

The more noise Congressional Democrats make, the more apparent it becomes that politics in Washington, dc, will not be able to move on until they get at least some of what they want. Already feeling let down by Mr Obama's tentative policies on issues such as gay rights, the Democratic base is

also likely to push tenaciously for an inquiry. But the intelligence services, not to mention Congressional Republicans, may never forgive him if he grants them one.

Education reform in Massachusetts

A chance for charters

Jul 16th 2009 | BOSTON
From The Economist print edition

Independent public schools may be getting a chance in the Bay State

Reuters

Soon to be under new management

MASSACHUSETTS ranks at or near the top of national measures of how well schoolchildren do at reading and mathematics. A leader in early-years education, it is also applauded for its vocational, technical and agriculture schools. Still, there are problems. The disparity between students in affluent districts and those in low-income urban ones is shocking. In the Concord/Carlisle school district, for instance, 92% of students graduated from high-school on time and planned to attend a four-year college or university in 2007, compared with just 12.8% in Holyoke, one of the poorest cities in the state.

Many states have turned to charter schools (self-governing publicly-funded schools) to close achievement gaps like that, but charters are a tricky subject in Massachusetts even though the few they do have, such as Boston Collegiate, are among the best in the country. Unions abhor them while the school boards that run most public schools fear losing power and funding. Politicians have been unwilling to take on Massachusetts's mighty unions.

Last year Deval Patrick, the self-styled "education governor" of the state, unveiled a 55-point plan to overhaul the state's education system. The governor's package includes the introduction of three types of "readiness schools" to turn around poorly performing districts. Like charters, they will have greater flexibility, autonomy and will be held accountable for their results. But they will not be fully independent, remaining under the control of local school boards. Mr Patrick will introduce a bill authorising these schools later this month. One sort would have an external partner, such as a university, while another would be teacher-led.

The most controversial type is the proposed "acceleration school". Underperforming schools, though remaining part of the school district, would come under state oversight as well. The legislation allows for the extension of the school day, changes to the curriculum, the introduction of pay by results for teachers and could involve the removal of school staff. But unions, which supports most of Mr Patrick's education blueprint, are worried "the collective bargaining rights of teachers" will be ignored.

Jim Stergios of The Pioneer Institute, a Boston-based think-tank, is happy to see more charter schools, but worries Mr Patrick's proposals do not go far enough. Arne Duncan, Barack Obama's secretary of education, is offering $5 billion for innovative cities and states. He has called on states to lift caps on the number of charters. Massachusetts has a cap, though Mr Deval wants to relax it a bit.

After years of dancing around the issue, Tom Menino, Boston's long-serving mayor, submitted legislation on July 7th that would convert his city's worst performing schools into charters. Failing this, he will push for the state to raise the cap on charters. A study by the Boston Foundation shows that charter schools do much better than other Boston public schools.

Mr Menino is facing strong challengers in his latest re-election bid. The cynical wonder if he is merely emulating his rivals' support for charter schools. Still, it seems at last Boston and Massachusetts may be on the verge of embracing them. The state's constitution demands that the state "cherish" its public schools. It is time the state began to cherish charters too.

Online education

Raising Alabama

Jul 16th 2009 | ALEXANDER CITY
From The Economist print edition

An experiment in levelling the playing field

ON A sweltering day in Alexander City, Alabama, summer school was in full swing. Two girls were reading "Julius Caesar" as two others wrestled with maths. A boy worked his way through a psychology quiz, and a teacher monitored an online discussion with students from around the state: Was Napoleon the last enlightened despot or the first modern dictator?

This is not a traditional classroom scene, but it has become common enough in Alabama. The state has many small, rural schools. Because of their size, and the relative scarcity of specialised teachers, course offerings have been limited. Students might have had to choose between chemistry or physics, or stop after two years of Spanish. But thanks to an innovative experiment with online education, the picture has changed dramatically.

In 2005 the governor, Bob Riley, announced a pilot programme called Alabama Connecting Classrooms Educators and Students Statewide, or ACCESS. The idea was to use internet and videoconferencing technology to link students in one town to teachers in another. It was something of a pet cause for Mr Riley, who comes from a rural county himself. He was especially keen that students should have a chance to learn Chinese.

There were sceptics. The pilot programme cost $10m, not pocket change in a poor state. Teachers worried about how they would connect to their virtual students. But ACCESS quickly became a hit. In 2006 students took more than 4,000 courses at 24 schools. In 2008, with ACCESS now in more schools, the number exceeded 22,000. Administrators are finding new ways to liven up the experience. Last year a dozen schools went on a "virtual field trip" to Antarctica, with scientists beamed in by satellite, and a school in Birmingham has been liaising with a counterpart in Wales.

As for the goal of levelling the academic playing field, the state is pleased so far. Mark Dixon, the governor's adviser for education, says that several years ago fewer than half of Alabama's public high schools offered any college-level Advanced Placement (AP) courses. As of this summer, they all will; ACCESS is being extended to all the state's schools.

Joe Morton, the state superintendent of schools, points to the number of black students taking AP courses. In 2003, according to the College Board, just 4.5% of Alabama's successful AP students (those who passed the subject exam) were black. In 2008 the number was up to 7.1%. There is still a staggering gap—almost a third of the state's students are black—but the improvement in Alabama was the largest in the country over that period. "That makes it all worthwhile right there," says Mr Morton.

Latinos and religion

Separated brothers

Jul 16th 2009 | LOS ANGELES
From The Economist print edition

Latinos are changing the nature of American religion

Eyevine

Moved by a new spirit

THE church of La Placita, "the little square", formally called Nuestra Señora Reina de Los Angeles, was founded under Spanish rule at around the same time as the pueblo bearing the same name, the future Los Angeles. As the land on which it stood became first Mexican and then American, it always stayed Latino in both look and character, says Father Richard Estrada. Catholicism and Hispanic culture seemed inseparable there.

They still largely are. Virtually all Father Estrada's parishioners are Hispanic, most of them of Mexican extraction. When Guatemalan and Salvadorean refugees showed up in the 1980s, it was natural for them, as good Catholics, to find sanctuary at La Placita, where they slept on the pews and Father Estrada gave them food. It was natural again in 2006, when the country went on an anti-immigrant binge, for many of the Latino counter-marches to start from La Placita. Latinos still come from all over southern California for baptisms and prayer, social services and a sense of community.

But more and more grandmothers also come to Father Estrada with worries about children or grandchildren who have become *hermanos separados*, separated brothers, after defecting to an evangelical church, usually one with a Pentecostal flavour. The converts may have followed one of the evangelicals who come to La Placita to recruit, or friends whom they met at a spiritual rock concert or picnic. "I don't worry, but I find it to be challenging," says Father Estrada.

Some 68% of Hispanics in America are still Catholic, according to the Pew Research Centre, a think-tank, and their absolute number, thanks to immigration and higher birth rates, continues to increase. But about 15% are now born-again evangelicals, who are fast gaining "market share", as Gaston Espinosa, a professor of religion at Claremont McKenna College, puts it. He estimates that about 3.9m Latino Catholics have converted, and that "for every one who comes back to the Catholic church, four leave it."

The main reason, he thinks, is ethnic identity. Evangelical services are not only in Spanish, as many Catholic sermons are nowadays, but are performed by Latinos rather than Irish or Polish-American priests, with the cadences, rhythms, innuendos and flow familiar from the mother country. The evangelical services tend to be livelier than Catholic liturgy and to last longer, often turning into an outing lasting the whole day. Women play greater roles, and there are fewer parishioners for each pastor than in the Catholic church.

The evangelical churches are also more "experiential", says Samuel Rodriguez, a third-generation Puerto Rican Pentecostal pastor and the president of the National Hispanic Christian Leadership Conference, an

evangelical association. In the Catholic church, a believer's relationship with Jesus is mediated through hierarchies and bureaucracies, he says, whereas the evangelical churches provide direct access to Jesus. The Pentecostals go one step further, with the "gifts of the Holy Spirit" (1 Corinthians) letting believers speak in tongues and pray for divine healing.

"This is the first group in America to reconcile both the vertical and the horizontal parts of the cross," says Mr Rodriguez. By this he means that the Latino evangelical churches emphasise not only "covenant, faith and righteousness" (the vertical part), as white evangelicals do, but also "community, public policy and social justice" (the horizontal part), as many black evangelicals, but fewer white ones, do. To Latino evangelicals it is all one thing, he says, and the social outreach the church provides goes far beyond any government programme, with pastors snatching young men away from gang life and fighting to uphold the rights of immigrants.

This also means that Latino evangelicals as a political force are distinct from white evangelicals. Many of the whites have veered hard right, hating abortion and gay marriage and reliably voting Republican, though less so very recently. Latinos tend to be even more pro-life and traditional marriage than whites, says Mr Rodriguez, but only because they know that "mom and dad in the home is the prime antidote to gangs and drugs." That same pragmatism makes them believe in government services and the taxes that pay for them, and of course in immigrant rights. As voters, he reckons, Latino evangelicals are therefore the quintessential independents, up for grabs by either party.

But it may be American Catholicism that changes the most. About a third of American Catholics are Latino now, and their share is growing. Their influence is not only physical and linguistic, with more of them turning up at church. They are also different Catholics, with more than half describing themselves as "charismatics", according to the Pew report. Charismatics remain in their traditional denomination, but believe in some aspects of Pentecostalism, such as the gifts of the Holy Spirit, especially the speaking in tongues.

Latino charismatics see themselves as a renewal movement within Catholicism, as it converges with other churches. And in general all churchgoing Latinos tend to see themselves as renewing Christianity in America. That makes them a powerful force as demographic changes turn America ever more Hispanic, and increasingly different from secular Europe.

Lexington

Glad to be godless

Jul 16th 2009
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Reflections on a summer camp for the children of atheists

Illustration by KAL

AS PART of a travelling Christian drama group, Don Sutterfield used to perform short plays. In one, a young man gives his girlfriend a rose and tries to persuade her to have premarital sex. The couple walk off, leaving the rose behind. Jesus picks it up and starts plucking the petals. "They love me, they love me not…"

Pious audiences loved it, says Mr Sutterfield. He and his chums would stand at the altar of a Pentecostal church, speaking in tongues, laying on hands and praying for members of the congregation to be delivered from sin, sickness and sexual perversion. Occasionally, they would attempt to drive out evil spirits. It was incredibly dramatic, says Mr Sutterfield: like the movie "The Exorcist", only with lots of exorcists. At the time, Mr Sutterfield was "immeasurably proud" of his work. But with hindsight, he thinks it was a load of mumbo-jumbo. He is now a militant atheist. He organises secular groups at universities and, this summer, volunteered at Camp Quest, a network of summer camps for secular kids. Lexington visited one in Clarksville, Ohio.

In most ways, it is like other summer camps. Kids aged 8 to 17 share cabins in the woods. During the day, they paddle canoes, shoot arrows, go swimming and explore nature. At night, they chat beneath the stars. Like other summer camps, Camp Quest satisfies a demand that springs from America's combination of very long holidays for children and very short ones for their parents. Unlike other camps, it is staffed entirely by humanists.

They are not pushy or preachy, but scepticism flavours nearly everything they do. Lunch comes with a five-minute talk about a famous freethinker. Campers are told that invisible unicorns inhabit the forest, and offered a prize if they can prove that the unicorns do not exist. The older kids learn something about the difficulty of proving a negative. The younger ones grow giggly at the prospect of stepping in invisible unicorn poop. There's a prize for the tidiest cabin, too, because "cleanliness is next to godlessness", jokes Amanda Metskas, the director.

Campers are not told that there is no God; only that they should weigh the evidence. They learn about the scientific method. An amateur biologist invites them to gather creepy-crawlies from a nearby pond. They are told how sensitive each species is to pollution, and asked to work out from this how polluted the pond is. They find several critters that can survive only in clean water, and conclude that the pond is in

good shape. The kids are encouraged to explore ethical questions, too. The more argumentative ones sit in a clearing and debate the nature of justice.

The kind of people who send their kids to Bible camp are appalled. Answers in Genesis, a Christian fundamentalist group, berates Camp Quest for drumming a "hopeless" world view into young minds. But a humanist camp is less about indoctrination than reassurance that it is all right not to be religious; that it is possible to be moral without believing in the supernatural. Nearly all the kids at Camp Quest say they find it comforting to be surrounded by others who share their lack of belief. Many attend schools where Christianity is taken for granted. Many keep quiet about their atheism. Those who don't are sometimes taunted or told they will burn in hell.

Atheists are broadly disliked in America. Only 5% of Americans admit that they would not vote for an otherwise qualified black presidential candidate, but 53% say they would shun an atheist. That makes the godless less popular than Muslims, Mormons or gays. Granted, the proportion of Americans who say they might vote for an atheist has doubled in the past half-century, and the polls are muddied by those who do not know what an atheist is.

Only one congressman—Pete Stark of California—openly admits to non-belief. When Barack Obama was inaugurated as president, he described America inclusively, as "a nation of Christians and Muslims, Jews and Hindus, and non-believers." But since then he has publicly invoked Jesus more frequently than George Bush junior did, according to *Politico*, a political newspaper. "I was surprised. I thought he'd be different," says Valerie, a 12-year-old at Camp Quest.

The lonely 1 in 12

Although America's atheists are not loved, they are not persecuted. Hate crimes against them are almost non-existent. In 2007 only six were reported to the FBI, and that included minor offences such as vandalism. (By way of comparison, there were 969 anti-Jewish hate crimes.) Of course, the fact that atheists are practically invisible makes them less vulnerable. A neo-Nazi can easily identify a synagogue or the Holocaust museum in Washington. But how do you spot an atheist? The guy you see walking a dog on Sunday morning could be planning to go to evensong.

Many atheists opt to remain in the closet, except perhaps with their closest friends. It is the path of least resistance. Deny the existence of God and you may be challenging your neighbours' most deeply held beliefs. That could get you ostracised, so why risk it? Yet living in the closet has costs. Christians have their beliefs constantly reinforced by neighbours who proudly and openly share them. Atheists often wrestle with their consciences alone, even though they are perhaps 8% of the population. Christopher Hitchens, the author of an antireligious polemic in 2007, observed that half the people who came to his book-promoting speeches had thought they were the only atheists in town.

Isolation matters especially when it comes to bringing up children, a tough task at the best of times. Christian parents can call on a vast support network of churches, Sunday schools, Bible camps and incidentally religious organisations such as the Boy Scouts. Atheists have precious little to compare with this. Small wonder the kids at Camp Quest seem so cheerful.

Economist.com/blogs/lexington

Bolivia's divisive president

The permanent campaign

Jul 16th 2009 | LA PAZ AND SANTA CRUZ
From The Economist print edition

Evo Morales is a popular president, but his brand of politics is dividing his country

Reuters

ON THE high plane, the *altiplano*, surrounding La Paz, where the landscape is drawn in shades of dusty brown, new brick buildings stand out against the bright sky. Most are residences of a couple of storeys, but there are schools and clinics too. Some even boast cement balustrades, a flourish that echoes the Spanish colonial style. In a place where there are still adobe houses, and where a dowry may be measured partly in potatoes freeze-dried by nights spent above 4,000 metres (13,000 feet), this is a transformation.

President Evo Morales's government has shovelled money towards this part of the country ever since he was elected in 2005. But its time in power has been deeply divisive. Leopoldo Fernández, an opposition politician who is governor of the Pando province in the north, has been in prison for ten months without standing trial. In March Victor Hugo Cárdenas, an Aymara Indian who was once the country's vice-president, had his house attacked by a mob after opposing a new constitution proposed by the government.

Abroad, Mr Morales's government has revelled in the worsening of a number of its most important relationships. It expelled the United States' ambassador, along with his country's drug-enforcement agents. The accusations of American plots against the government had abated in anticipation of the new Obama administration, but business has now returned to usual, with President Morales expelling another American diplomat and lambasting the United States for refusing to renew a preferential trade agreement that is linked to Bolivia's performance on combating its drug barons. Bolivia's relations with Peru are awful and it has failed to convince Brazil to abandon plans for new hydro resources in the Amazon which will lessen its demand for Bolivia's gas.

In part this drive to isolate the country is deliberate. Many in the government dream of an economic autarky, powered by gas. Yet Mr Morales has accepted help from Venezuela, Cuba, Russia and Iran to further his "Movement to Socialism" (MAS) party. Venezuelan troops helped quell a rebellion centred on the airport at Santa Cruz in the east in 2007.

The antagonism between the government in the Andean city of La Paz and its opponents in Santa Cruz is Bolivia's clearest fault line. The conflict is usually described as pitting indigenous Bolivians in the uplands against descendants of Spain in the lowlands, or poor versus rich, but in fact Santa Cruz is ethnically mixed and average incomes in the two cities are comparable. Instead, the conflict is one of identity. The *cruceños* see themselves as pioneers who carved prosperity out of a pestilential jungle. Those who live on the *altiplano* are likely to view Mr Morales, the country's first indigenous president, with pride and to think that his government offers them a chance to get their share of revenues from the gasfields around Santa Cruz. By contrast, the *cruceño* elite fear losing their property, businesses and power.

This fear has increased since April, when government troops burst into the Hotel Las Américas in Santa Cruz, killed three men and arrested two others. The government claimed that this raid prevented an assassination attempt on Mr Morales. The hotel, all brown marble and glass with a few sad ferns in the atrium, seems an unlikely base for a terrorist cell, and the supposed terrorists were an unlikely bunch. That three of them were killed in their beds rather than spared for interrogation has aroused suspicion that they were in effect executed.

Whatever the case, a continuing investigation acts as a useful reminder to would-be rebels that they should stay in line. It has also destroyed any kind of moderate opposition. Carlos Dabdoub Arrien, one of the more constitutionally minded of the government's opponents in Santa Cruz, describes Mr Morales as an "indigenous fascist".

Those new brick houses on the *altiplano* are likely to keep Mr Morales in power in the elections due at the end of the year. He has handsomely increased government spending for the past three years, including much-needed increases in cash-transfer programmes. Some of these were inherited from the previous government, but they have been boosted and renamed. One programme is called "Bolivia changes, Evo delivers".

Maybe. But at least one pundit, reckoning that the voters are still unlikely to give Mr Morales the landslide he craves in the legislature, says Bolivia is suffering a classic bout of Latin American populism: personalised politics, mild paranoia, bad economic policy and a weak opposition.

Peru's reshuffled government

Playing for time

Jul 16th 2009 | LIMA
From The Economist print edition

An unpopular president looks to new ministers

Reuters

The president still smiles

INTRODUCING a revamped cabinet on July 11th, with seven new faces among the 16 ministers, Peru's President Alan García said he hoped it would be his last reshuffle before his five-year term ends in July 2011. Not only did no one believe him but most pundits predict that the cabinet's new leader, Javier Velásquez, the third to hold the post in the past nine months, will last as head of the government only to the end of this year, or—optimistically—until April next year, when the campaign for local elections gets under way.

The problem is that the president's popularity rating hovers around a dismal 20% and the pressures, from corruption scandals to social unrest, are growing. Last month was particularly cruel. Demonstrations by Peru's Indians that began in April burst into violence on June 5th near the northern jungle town of Bagua. The official death toll was 33, with 23 police officers among the dead. One police officer remains missing.

It was that violence which led to the reshuffle, after Mr Velásquez's predecessor, Yehude Simon, was forced out along with the ministers in charge of the police and the armed forces. Mr Simon spent the weeks between the Bagua clash and his fall from grace travelling around Peru to deal with one disturbance after another: some 273 at the end of June, according to the human-rights ombudsman. The country's chambers of commerce reckon protests and strikes during the month resulted in losses of at least $295m.

The troubles are not over. Three days of national protests preceded the reshuffle. Mr García claims that only 50,000 people, out of Peru's 29m, took to the streets, but critics say that argument is irrelevant."The government in Lima simply does not listen. Many of the conflicts in the country have been created by decisions based on what the administration wants to do and not what Peruvians want it to do," says Rómulo Triveño, president of the Ica region, south of the capital. Meanwhile, recently released statistics for April have recorded the first monthly GDP decline since mid-2001 and the country has suffered its first deaths from swine flu. Those deaths had a political impact, coming a day after Mr García said that his government would defeat the disease, as well as the international financial crisis, by the year's end.

Mr Velásquez, like Mr García, is a member of the ruling APRA party and both could suffer from a judicial decision to allow Romulo León, a fellow apra member who was allegedly involved in corruption, to leave prison for house arrest. Mr León's supposed misdeeds—which he denies—prompted the first big cabinet shake-up last October. Opponents smell a cover-up, even though there is no evidence of one.

The bad political news is taking place against a background of generally good economic news. Despite the latest GDP figures and a slowdown from last year's 10% growth rate, Peru will still be one of the few Latin American countries to register positive growth for the year as a whole. Inflation is falling rapidly and the country's trade surplus has increased, topping $1 billion for the first five months of the year.

Poor Mr García, then: his presidency risks becoming a lame duck prematurely. Already 21 parties have registered before the presidential elections due in 2011 and dozens more are trying to collect the 145,000 names needed to run—among them two of the victims of last week's reshuffle, Mr Simon and the former armed-forces minister, Antero Flores Aráoz.

Mexico and the disabled

Lending a hand

Jul 16th 2009 | MEXICO CITY
From The Economist print edition

Help for the handicapped can be a way of helping everyone

AT THE main international airport for Mexico City, the first thing to notice is that the path from the baggage claim is lined with smiling employees guiding passengers to their taxis or connecting flights. The second is that they are all in wheelchairs. Since the opening of a new terminal in November 2007, the airport has hired some 60 disabled, bilingual workers to serve as Mexico's face to the world. Their presence delights both passengers, who frequently offer congratulations and ask to take their picture, and their superiors. "They're professional, attentive, always in a good mood, and never miss work," says Héctor Velázquez, the airport's director.

Mr Velázquez says he first thought of seeking out disabled staff after being impressed by the performance of Jazmín Flores Martínez, a young labour lawyer suffering from severe arthritis. He instructed a subcontracting firm to take on 20 graduates of a physical and psychological training programme for the handicapped, and then tripled the programme's size upon seeing the results. The workers say they are thrilled by the public exposure—and by their respectable $550 a month salaries. "If you don't have a job, you sit at home all day thinking about what hurts," says Ms Martínez. "Now, we're independent, and people can see that our physical condition doesn't matter. They don't look at you as some strange creature any more."

Another beneficiary is the Mexican government, now at the vanguard of the disabled-rights movement in the developing world. In 2005 it established a council to co-ordinate its efforts across state agencies. Since then, the government has launched a number of initiatives, including installing wheelchair ramps in 26,000 schools, and providing subsidised loans for housing for the disabled. According to the council, the proportion of government buildings accessible to the handicapped will increase from 40% to 90% by 2012, and all hospitals will include sign-language interpreters by the same date.

Unhappily, the example set by the airport is rare. Employment among the disabled, who represent nearly 10% of Mexico's population, is less than half that of the rest of society, and in the public sector just 0.4% of workers are disabled, according to the National Council for People with Disabilities. Perhaps the most promising avenue for progress is the example of the airport employees: Jesús Carbajal Briones, one of Terminal 2's wheelchair battalion, says businessmen passing through routinely ask him about hiring his counterparts.

China's recovery

A fine balancing act

Jul 16th 2009 | HONG KONG
From The Economist print edition

Reuters

Is the economic stimulus too much of a good thing?

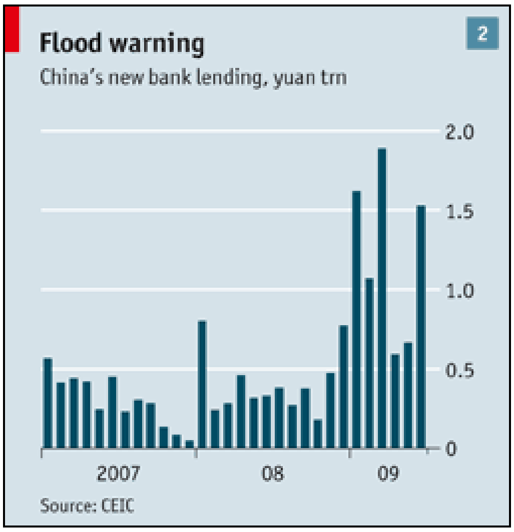
CHINESE growth was already the envy of the world. Now recession-stricken countries will be turning an even brighter green. On July 16th new figures showed China's GDP growth quickened to 7.9% in the year to the second quarter. That is healthy enough by anyone's standards but the headline number conceals a more astonishing rebound. Goldman Sachs estimates that GDP grew at an annualised rate of 16.5% in the second quarter compared with the previous three months (see chart 1). Over the same period, America's economy probably contracted again. China's economic stimulus has clearly been hugely effective. So effective, indeed, that some economists are now worrying it may be working rather too well.

In the year to June fixed investment surged by 35%, car sales rose by 48%, and purchases of homes by more than 80%. After falling last year, home prices are now rising briskly in some big cities, and share prices have soared by 80% from their November low. Domestic spending has been spurred partly by the government's stimulus package, but probably even more important was the scrapping of restrictions on bank lending late last year. In June new lending was more than four times larger than a year earlier (chart 2).

One reason why the economy has rebounded so quickly is that much of the slowdown was self-inflicted, rather than the result of America's economic collapse. In 2007 concerns about overheating prompted the government to curb the flow of credit for construction and home buying. This caused China's economy to slow sharply even before the global financial crisis. Then, last November, the government turned the credit tap back on full.

That has given a big boost to domestic spending but raised concerns that the flood of liquidity will push up inflation, fuel bubbles in shares and housing, and store up bad loans. The M2 measure of money surged by 29% in the year to June. In fact the

risk of high inflation in the near future appears low: Chinese consumer prices fell by 1.7% in the year to June, and spare capacity at home and abroad is holding down prices. But asset prices could be a bigger danger. According to one estimate, 20% of new lending went into the stockmarket in the first five months of this year.



It is probably too soon to use the word “bubble”. The stockmarket is still at only half its 2007 peak and, although house prices have risen sharply this year in Shanghai and Shenzhen, the nationwide average is barely higher than it was a year ago. But the pace of bank lending is unsustainable, and America’s recent experience suggests that it is better to prevent bubbles forming than to mop up the mess afterwards. Several officials at the central bank have said lending should be curbed.

At the moment, the prime minister, Wen Jiabao, is signalling that he wants monetary policy kept fairly loose. Exports remain weak and the government fears premature tightening could derail the recovery. It is also keen to create jobs and maintain social stability in the months before the 60th anniversary of Communist Party rule in October.

Still, the central bank has begun to tug gently at the reins. It has nudged up money-market interest rates and warned banks that it intends to increase its scrutiny of new bank loans. The China Banking Regulatory Commission has warned banks to stick to rules on mortgages for second homes, which require a down-payment of at least 40% of a property’s value.

The recent rebound in house sales is, in fact, exactly what the government is aiming for, since it is using property as a way to spur private consumption. Higher house sales encourage more spending on furniture and consumer appliances. Construction also creates lots of jobs; indeed, it employs almost as many workers as the export sector. Since October the government has encouraged people to buy houses by cutting the minimum mortgage down-payment on their main home from 30% to 20% and by reducing stamp duty and other taxes on property transactions. Stronger sales are now feeding through into new house building: housing starts rose by 12% in the year to June, the first growth in 12 months.

Given the importance of property to domestic demand, the government is highly unlikely to want to clamp down hard on the housing market. Despite the recent lending boom, Chinese banks’ mortgage lending is still very conservative compared with that in America—at the peak of America’s housing bubble it was easy to get a mortgage for 100% or more of the value of a home. Nevertheless, the lesson of America’s financial crisis for China’s government is plain: overly loose lending should never be ignored.

The Uighurs, Central Asia and Turkey

Troubles across Turkestan

Jul 16th 2009 | ALMATY, ANKARA AND BEIJING
From The Economist print edition

Contrasting responses to China's crackdown in Xinjiang

THE plight of Turkey's Kurdish minority has never been of compelling interest to ordinary Chinese people. But in the past few days internet forums in China have been clamouring their support for Kurdish separatists. As Chinese security forces reimpose order after a bloody spasm of ethnic unrest in Xinjiang, Turkey is finding itself in the line of fire.

The country's prime minister, Recep Tayyip Erdogan, helped ensure this by suggesting that the recent violence in Xinjiang's capital Urumqi involved "genocide". The rioting in Urumqi began with attacks by Turkic-speaking Uighurs on ethnic Han Chinese, but the reaction of the security forces and reprisals by Han mobs has claimed dozens of Uighur lives. China's official media says the latest death toll is 192, at least 46 of them Uighurs (though it is unclear if the count includes two Uighurs killed by police on July 13th). Turkey's trade minister Nihat Ergun hinted strongly that Turkish consumers should boycott Chinese goods (though his ministry quickly said that this was a personal view). Mr Erdogan proposed a discussion of the rioting in the UN Security Council. This is a non-starter given China's power of veto, but the very idea infuriated China.

Turkey's cultural, religious and ethnic links with Xinjiang make it difficult for leaders there to keep quiet. Turkey has long been a haven for disaffected Uighurs, including Isa Yusuf Alptekin, the pre-eminent leader of Uighur nationalism until his death in 1995. To China's fury, Mr Erdogan, when mayor of Istanbul, named part of a central park after Alptekin in the 1990s.

In recent years Turkey's support for the Uighur cause had been dampened by China's rapid economic rise and its growing international clout. In 2003 Mr Erdogan visited China with a large delegation to mend relations. A few days before rioting erupted in Urumqi, Turkey's President Abdullah Gul also paid a visit, saying afterwards that relations had turned "a new page". They are now in tatters.

In contrast, most Western and Muslim countries have not seen much benefit in riling China over an issue that arouses little international attention compared with human-rights abuses in neighbouring Tibet. The reaction to Xinjiang's unrest among Central Asian countries which are home to Turkic peoples has also been muted. The immediate concern for the Kazakh and Kyrgyz governments has been the safe return from Xinjiang of their citizens, many of them shuttle traders. Both countries have sizeable Uighur populations—50,000 in Kyrgyzstan; 300,000 in Kazakhstan (including the prime minister, Karim Massimov). There are also an estimated 1m ethnic Kazakhs in Xinjiang, who complain that they face the same sort of pressure on their culture and traditions as the Uighur.

Mindful of China's proximity, and of the dangers of being sucked into further unrest, the "stans" have taken a dim view of Uighur separatism. Kazakhstan, for example, has sent a few separatists wanted by China back to Xinjiang. In Turkey, by contrast, Mr Erdogan has offered a visa to Rebiya Kadeer, a Uighur exile accused by China of fomenting Xinjiang's violence.

The rewards of Central Asia's co-operation are obvious. In April China agreed to lend Kazakhstan $10 billion in a "loan-for-oil" deal. In June it offered another $10 billion in credit to members of the Shanghai Co-operation Organisation—which links four Central Asian states with Russia and China—to shore up their struggling economies. As Turkey will find, there may be little to be gained by supporting the hapless Uighurs, except, perhaps, secret sympathy for its stance beyond China.

Malaysia's opposition

Anwar holds the PAS

Jul 16th 2009 | MANEK URAI, KELANTAN
From The Economist print edition

How stable is Malaysia's would-be coalition government?

Illustration by Claudio Munoz

LIFE in the rubber-tapping villages of Manek Urai, in north-eastern Malaysia, rarely raises the pulse. How much more exciting, then, was the July 14th state by-election, narrowly won by a pious fishmonger. During the campaign, a bevy of national politicians descended on the district to woo its 12,293 voters, whose former assemblyman from the opposition Islamic Party (PAS) had died in May. As usual, Malaysia's ruling coalition did not come empty-handed: villagers in Manek Urai were promised a new bridge if they chose wisely. Instead, they stuck with PAS, by just 65 votes.

The bridge will have to wait, but PAS's celebrations had more to do with relief than joy. Politically, the by-election victory counts for little as PAS already has a comfortable majority in conservative Kelantan, one of four states ruled by the opposition. But the symbolism is potent. The seat is rural and dominated by ethnic Malays, who form the bedrock of support not only for PAS but for the United Malays National Organisation (UMNO), the dominant party of the ruling coalition. The vote was the first since a new prime minister, Najib Razak, took office in April. A victory would have snapped UMNO's losing streak. In March 2008 the government surrendered its cherished two-thirds majority in parliament. It has lost five of six subsequent by-elections to opponents led by a former deputy prime minister, Anwar Ibrahim, who went on trial this week on a sodomy charge that he calls politically motivated.

Mr Anwar is the glue holding together an unlikely alliance of the Islamist PAS, the secular Democratic Action Party (DAP) and a multiracial party of his own called the People's Justice party. The coalition is riven by ideological splits and statehouse squabbles and Mr Anwar's legal troubles have unsettled it further. The DAP recently threatened to quit a PAS-led state government after it demolished an unlicensed pig abattoir. Party officials feud openly.

Naturally, the government likes to play up such incidents. But the divisions, while manageable, are real, admits Liew Chin Tong, a member of parliament for the DAP. The main question is how far to protect the rights and interests of the Malay majority. This sometimes pits the Chinese-oriented Dap on the one hand against both PAS and UMNO on the other, leading some PAS figures to talk up the idea of a detente between the two parties—though they have been slapped down by PAS's spiritual leader (and chief minister of Kelantan) Nik Aziz Nik Mat. PAS itself is split between old-guard clerical conservatives, who favour unity talks and more Islamic laws, and a moderate faction known as "Erdogan", after Turkey's prime minister, Recep Tayyip Erdogan.

That Malaysia's politics pivots on the whims of a divided Islamist party which favours sharia law sounds alarming. Various sharia laws are on the books in Kelantan (including stoning for adulterers and rapists), though the federal government has blocked their enforcement. PAS officials are fuzzy on what would happen if, as seems probable, the opposition eventually comes to power at the national level. But the likelihood is that secular laws would prevail, given the coalition's make-up. In addition, PAS has in fact shed much of its fundamentalist baggage over time. It has rebranded its emphasis on Islamic jurisprudence as a commitment to social justice and clean governance—in contrast to UMNO's money-grubbing image. Over the past decade, young Malay professionals from outside its northeastern base have swollen its ranks. Some are now standing for office and, remarkably, winning the support of Chinese and Indian voters. Even UMNO officials concede that PAS has moved into the mainstream.

It remains possible that PAS could split, with part buttressing UMNO in government and part staying in opposition. Conservatives in the rural heartland may be tempted to jump ship if UMNO dangles the right

goodies, arguing that safeguarding Malay rights trumps everything else. But that would bring them into conflict with Mr Anwar, who wants to abolish the much-abused racial-quota system and tackle poverty among all races. And PAS members who do link arms with UMNO run the risk of alienating voters who want change at the top and are willing to forgo electoral bribes—as the villagers of Manek Urai showed.

India and Pakistan

Sharm offensive

Jul 16th 2009 | ISLAMABAD
From The Economist print edition

The prime ministers meet to talk about restoring peace talks

AS THE prime ministers of India and Pakistan prepared to air bilateral grievances at a meeting in Egypt on July 15th, Indian police issued a reminder of the most urgent of them—warning of a fresh terrorist threat in Mumbai, the Indian port-city devastated by Pakistani terrorists last November. That outrage caused India to withdraw from a promising four-year diplomatic effort to normalise relations between the two old rivals. This week's meeting between Manmohan Singh, India's prime minister, and Pakistan's Yusuf Raza Gilani, on the fringes of a summit of the Non-Aligned Movement in Sharm el-Sheikh, was the first serious effort to talk about terms on which it can be restored.

Since Mumbai, India has demanded Pakistan bring to justice those responsible for the attack, in which 175 people died, and dismantle the networks of anti-Indian militancy that spawned them. Yet in recently declaring himself ready to meet Pakistan "more than halfway", Mr Singh sounded a more conciliatory note. As *The Economist* went to press, it seemed likely that, provided Pakistan prosecutes, in earnest, five alleged ringleaders of the attack (as on July 12th it said it would start doing this week), and if it gives further evidence of its seriousness in investigating the plot, India will agree to restart the peace process soon.

It is a sign of that process's former strength that both countries want this. A "composite dialogue" aimed at settling outstanding disputes which was launched in 2004 by India's then prime minister, Atal Behari Vajpayee, and Pakistan's then generalissimo, Pervez Musharraf, the process brought the foes closer together than at any time in their violent history. They reached outline agreements on how to settle three territorial disputes—including, though most tentatively, the status of divided Kashmir, over which they have fought three of their four wars.

And war became less likely—as demonstrated by India's laudable restraint after Mumbai, when, against the wishes of many Indian commentators, it threatened Pakistan with no military reprisal. After an attack on the Indian parliament by Pakistani Islamists in 2001, by comparison, both sides rushed troops to their frontier, and raised a threat of nuclear war.

Yet the peace process will not recommence in its former hopeful place. In the latter part of 2006, it had promised a swift end to disputes over the Sir Creek estuary, which has prevented demarcation of the countries' maritime border, and the Siachen glacier at the edge of the front-line that divides Kashmir. According to proposals put forward by Mr Musharraf, even that fault could have been mended: mainly by turning Kashmir's front-line into a "soft border" and granting autonomy to Kashmiris either side of it. This was an historic recognition by Pakistan that India will not relinquish its richer portion of Kashmir. Yet India was reluctant to make any deal. And as Mr Musharraf became distracted by a losing battle to retain power, the peace process drifted.

Once resumed, the talks are likely to be dominated by how to combat terrorism, not solve Kashmir. Nor is India likely to welcome settlements on any other issue until Pakistan shows more signs of clamping down on the Islamist militants it once launched against India—including Lashkar-e-Toiba (LET), the banned group responsible for the Mumbai attack, whose founder and alleged leader, Hafiz Saeed, was released from house arrest in Punjab last month. Under Indian pressure, Pakistan's government launched a half-hearted legal challenge to Mr Saeed's release. But so long as it fails to charge him and his most senior lieutenants with any serious crime—such as killings carried out by LET when they were its undisputed bosses—they are likely to remain at large, preaching jihad against India.

Child soldiers in Sri Lanka

Retraining Tiger cubs

Jul 16th 2009 | AMBEPUSSA AND COLOMBO
From The Economist print edition

Is as hard as it sounds

AFP

In Ambepussa, child soldiers struggle to be children again

FAIRNESS cream; scented hair oil; talcum powder: these are things that female ex-combatants of the Tamil Tiger rebels, many forcibly recruited as children, hesitantly ask for when placed in rehabilitation. Thousands of exhausted rebels surrendered in the weeks before the government declared its victory over the Liberation Tigers of Tamil Eelam (LTTE) in May. The army says more than 9,000 are now in custody. Some face prosecution; more are being absorbed into the army; others will be sent into rehabilitation as soon as space becomes available in these overburdened camps. But to judge by the stories of the former child soldiers, turning their lives around will be a lot harder than providing some of the frills denied them during their years of warfare.

The Protection and Rehabilitation Centre in Ambepussa is run by the Bureau of the Commissioner-General of Rehabilitation. To reach it, you take a narrow lane that snakes through paddy fields and thick woods, climbs a steep incline and stops at a neat collection of single-storey buildings. As the LTTE fought its final, doomed battle, 112 ex-fighters arrived there, fresh from combat, aged between 14 and 29.

Tall and thin, a young man with fragile features is summoned by army officers. Ganeshalingam Thayalan speaks softly, uncertainly. He has just turned 18. Today, he pores over maths and chemistry books to pass his advanced-level examination and enter university. There is no hint from his outward appearance that Thayalan was a trained suicide bomber

He was just two when his parents died in an air-force bombing and he was sent to Sencholai, a rebel "orphanage" in the Kilinochchi district. Every school holiday, he was trained in the use of weapons, psychological warfare, combat skills, and other military activity. After his ordinary-level exams he was taught to be a human bomb. The Tigers showed him how to wear and activate a suicide jacket. It was a compulsory lesson: other friends from Sencholai also had to learn it.

The LTTE subsequently deployed Thayalan in Vavuniya and ordered him to continue studying until they found him a target. He was living with a friend when, acting on a tip-off, the police arrested him. Would he have exploded himself when told to? Yes, he says, because the Tigers were watching. If he had disobeyed, they would have killed him anyway.

The rehabilitation centre provides children and adults with vocational training, and education in maths, computer science and languages, including Sinhalese, the tongue of the majority Sinhala Buddhists they had once been coached to kill. There are cultural and sporting events and occasional field trips. But the children are chaperoned on all excursions and, while parents and relatives may visit, the centre is not open to outsiders. In October 2000 a Sinhala mob attacked a similar venture in Bindunuwewa and killed 26 people.

Hiranthi Wijemanne, a consultant to the commissioner general, says that most of the inmates want to leave the country after rehabilitation. Social stigma will not permit them to return to their own villages or to mingle with the population in the Sinhala-dominated south. More than 50 reformed fighters have already gone abroad.

James Elder, a spokesman for Unicef in Sri Lanka, calls the centre a genuine attempt to help child soldiers learn how to be civilians. From 2003 to the end of 2008, Unicef recorded more than 6,000 cases of child recruitment by the rebels but the number is thought to have soared in the final months of the war. To cope with the influx, the bureau is expanding its centres in the northern Jaffna peninsula and Welikanda in the east. It is also building a new facility in Vavuniya, where many ex-combatants now while away the time, awaiting their turn.

Muslim insurgency in the Philippines

Jolo man

Jul 16th 2009 | MANILA
From The Economist print edition

Hope and worry in equal measure

IT SEEMED like unalloyed good news. On July 12th Abu Sayyaf, a band of armed Muslims who operate in the southern Philippines and have links to al-Qaeda, released Eugenio Vagni, a 62-year-old Italian, the last of three International Red Cross workers whom the group had kidnapped six months before. Government officials claimed he had been released because the security forces had put unbearable military pressure on the kidnappers. They demanded a final offensive to eradicate Abu Sayyaf.

But such demands have been heard many times. Suspicion has surfaced in the Philippine media that ransom was paid, as has happened before. Most worrying of all, other more dangerous groups may be moving into Abu Sayyaf's territory.

The group was founded by Filipinos who fought in Afghanistan against the Soviet Union and returned home to help in the military struggle for independence begun by their fellow-Muslims in the southern Philippines. The group soon turned to murderous banditry—in the past they have beheaded hostages—and the Philippine and American governments regard them as terrorists. The security forces made use of American training, equipment and intelligence as they chased Mr Vagni's captors around the hills and jungles of Jolo, an island in the south-west.

But what really worries the Americans is the lawlessness that allows Abu Sayyaf to endure. Areas where the security forces cannot or will not penetrate have become training grounds for other militant groups, notably Jemaah Islamiya, al-Qaeda's offshoot in South-East Asia. Several times during Mr Vagni's captivity, officials said Indonesians known to be members of Jemaah Islamiya were spotted among the kidnappers. Just before his release, southern cities suffered a fatal series of bombings that bore Jemaah Islamiya's hallmarks.

The Americans are encouraging the government and the main Muslim separatist group, the Moro Islamic Liberation Front, to talk peace. They hope that peace and order in the south will squeeze Jemaah Islamiya out. But until the security forces get around to mounting their final offensive against Abu Sayyaf, the areas where kidnappers are free to roam are likely to remain a base from which Jemaah Islamiya can strike.

Banyan

End of the line for the LDP

Jul 16th 2009
From The Economist print edition

Japan has long been changing faster than its Liberal Democratic Party, which is now in terminal decline

Illustration by M. Morgenstern

HIS distraught colleagues cannot forgive Taro Aso for calling a general election on August 30th, following a dismal stint as prime minister. They accuse him of setting up the opposition Democratic Party of Japan (DPJ) for a landslide victory, so bringing the long rule of the Liberal Democratic Party (LDP) to an abrupt and ignominious end.

Yet the question is not why the LDP's rule looks about to end soon. Rather it is how on earth the party managed to cling on to power for so long. A once-invincible party failed to adapt to wholesale changes in the social and economic model that it was set up to manage. If its 54-year rule really does come to a halt, that fact alone will confront both party and country with wrenching change and unprecedented uncertainty.

Few things more powerfully demonstrate the inbred character of LDP-dominated politics than its family background. Mr Aso's grandfather, Shigeru Yoshida, was the great statesman of shattered Japan's post-war reconstruction. Yoshida's rule came to an end in 1954 when he was unseated as prime minister by his nemesis, Ichiro Hatoyama. The next year the two men joined forces and the Liberal Party merged with the Japan Democratic Party to form the Liberal Democratic Party, which has dominated Japan's politics ever since. The man who will bring the LDP's rule to an end this summer is Hatoyama's grandson, Yukio Hatoyama, leader of the DPJ. Family honour is demanding its due: for Shigeru Yoshida's grandson, it is nobler to fall to Ichiro Hatoyama's descendant than to succumb to mere LDP hoplites. In any case, Mr Aso knows no one can save his party now.

That is because its history runs so deep. Old Hatoyama and Yoshida formed the LDP as a bulwark against resurgent socialist parties and the political system they devised seems expressly designed to resist change. The American occupiers had anyway pushed Japan in a conservative direction as early as 1948, when the risk of communist revolution in Japan and China—to say nothing of the Soviet threat—had come to be seen as a greater peril than militarism. The Korean war reinforced these priorities, while adding an economic dimension: the United States needed Japan's economy to be humming again to help the war effort.

Thus developed Japan's characteristic mix of anti-communist—even anti-civic—politics with state-directed

development and policy set by bureaucrats. Yoshida founded the Ministry for International Trade and Industry, MITI, whose bureaucrats were famously powerful. Trust-busting efforts were quickly wound down after the second world war. Oligopolies—in the form of the former *zaibatsu* conglomerates—were supported, even if they had been implicated in Japanese aggression. A man accused of war crimes became a notable post-war prime minister and Yakuza gang bosses consorted with top politicians and helped put down left-wing protests. The political and bureaucratic system was solidly made and has lasted, like so many things in Japan. But its origins, and its effects on Japan, were ultimately rotten.

In some countries—Italy, say—incestuous politics is resented, mocked or circumvented by the rest of the country. During Japan's boom years, it seemed to be delivering the goods. Outside the radical left, most Japanese were bought off by a social contract in which politicians, bureaucrats and big business arranged the country's economic affairs. Businesses won preferential finance and in return offered "salarymen" job guarantees and the dream of a middle-class life. But the contract could be honoured only with high rates of growth, and the oil shocks of the early 1970s put paid to these.

Perhaps this might have been the end of the LDP, but political competition had been so stifled that there was nothing to take the party's place. Instead, the crisis of the 1970s led to a steep rise in corruption. Factional competition within the party increased. Fund-raising skills came to the fore (in Japan, like America, politicians mostly finance their own campaigns). So did the ability to fund public works in rural areas that were still the LDP's base. Corruption cemented local baronies and for a good while won votes. Even today the late Kakuei Tanaka, an astonishingly corrupt prime minister, is more often praised than cursed.

The beginning of the end

A 19th-century Russian said that Europe's democracies were moderated by corruption. Japan had corruption moderated by democracy. During the 1980s, the LDP managed to adapt itself somewhat to new political concerns, such as pollution and the success of issue-driven opposition figures in cities and prefectures. The party even lost power briefly in 1993 and, in 2001-06, a razzle-dazzle prime minister, Junichiro Koizumi, seemed to be giving it a new lease on life.

But by the time Mr Koizumi came along, the tension had become intolerable between the change-resisting features of politics on the one hand, and the reality of profound economic and social upheaval on the other. Companies could no longer keep lifetime promises to workers yet the government failed to take over social-welfare obligations. Women wanted better work prospects yet ministers would refer to them as "breeding machines". The demands of civic groups for more consumer protection were met grudgingly and late.

Now, the LDP has abandoned nearly all pretence at reform. Though the party has plenty of modernisers, many—notably the so-called Koizumi's children—will be the first to be swept out on August 30th while the old guard may survive better because they have their own sources of funding and support. That the LDP is still so mired in the past shows both why its fall would be such an historic moment and why it would also be only the start of real change. The party was the keystone of a political system that has long been crumbling. To effect change means not just replacing the keystone but painstakingly rebuilding the arch.

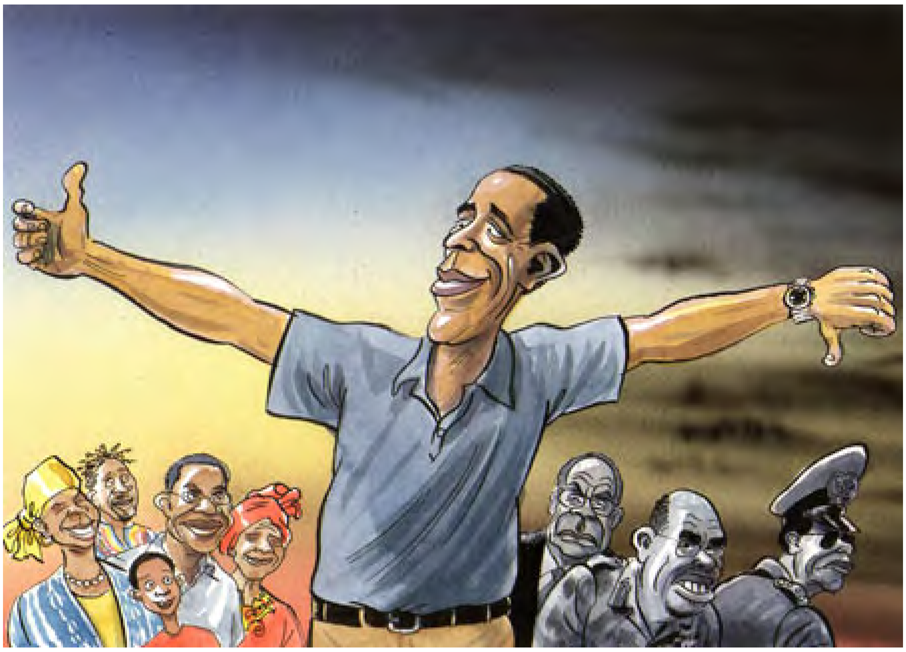
Barack Obama and Africa

How different is his policy?

Jul 16th 2009
From The Economist print edition

Barack Obama said all the right things about Africa—and left a few ticklish ones unsaid. The tone may shift a bit but the policy will be similar to George Bush's

Illustration by Peter Schrank



"DEVELOPMENT depends on good governance." Said by a white Texan dynast in Ghana, an African country once ravaged by the slave trade, that unexceptionable insight might sound a shade patronising. Said by a son of Africa whose election to the world's most powerful post thrilled the continent, it was taken at its respectable face value. "We must start from the simple premise that Africa's future is up to Africans." In other words, throwing aid at bad governments—and Barack Obama made plain that there were still far too many of them—will not work. The president's candour was well received.

In truth, Mr Obama's Africa policy is unlikely to differ much from his predecessor's, which was viewed favourably by Africans in general and by most pundits of African development. There was little in the speech that could not have been said by George Bush, who poured a cascade of cash—far more than any of his forerunners—into such projects as the President's Emergency Plan for AIDS Relief (PEPFAR) and into his Millennium Challenge Accounts, whose largesse was partly meant to reward good governance.

Mr Obama acknowledged Mr Bush's "strong efforts". But he puzzled analysts by declaring that his own administration had "committed $63 billion to meet these challenges". It was unclear whether that sum included projects under way or was new money and, either way, what it was for and over what period it would be spent.

In several passages he stressed that bad governments, especially corrupt or repressive ones, could not expect his help. "I have directed my administration to give greater attention to corruption in our human-rights reports," he said. He also assailed tribalism, which had, he said, "for a long stretch derailed" his own Kenyan father's career. And he singled out several miscreants for blaming their self-inflicted woes on others. "The West is not responsible for the destruction of the Zimbabwean economy over the last decade," he declared.

The choice of Ghana for his first African visit as president was pointed. Citing its recent success both in economics and democracy, he praised "strong parliaments; honest police forces; independent judges

[applause]; an independent press; a vibrant private sector; a civil society." And he lauded "leaders who accept defeat graciously", as they did recently in Ghana, a rare event in Africa. "Africa doesn't need strong men; it needs strong institutions."

Mr Obama's speech was equally notable for what it omitted. Some delicate but pressing issues were mentioned only cursorily. In keeping with his pronouncements elsewhere in the world, he avoided the phrase "war on terror" and skated over America's growing need for African oil: about a quarter of what America requires will soon come from Africa, mainly Nigeria and Angola. He did not mention Nigeria's crisis of security and production in its oil-rich Delta region; this week, rebels for the first time attacked Nigeria's commercial capital, Lagos, killing eight guards and setting oil facilities ablaze.

In fact, though Mr Obama did not wish to dwell on security, his biggest headaches in Africa, as for Mr Bush, do still relate to armed conflict. His worst problem is Somalia, where his closest advisers upbraided Mr Bush for worsening matters by arming Somali warlords who claimed to be fighting militant Islam. More recently, however, Mr Obama won a waiver from the UN to send arms to Somalia's beleaguered government, which is threatened by jihadists ("terrorists", he bluntly called them) with links to al-Qaeda. He is unlikely to let his warships or aircraft bomb jihadist strongholds in Somalia for fear of enraging the civilian population. But equally he is plainly loth to let that failed state slide further into the domain of al-Qaeda.

Rather vaguely, he welcomed "steps being taken by organisations like the Africa Union…to better resolve conflicts." The AU, he preferred not to say, is patently failing to bolster Somalia's government. Several of Mr Obama's closest advisers on Africa are known to be disgusted by the AU's refusal to isolate—let alone encourage the arrest of—Omar al-Bashir, Sudan's leader, who has been indicted on charges of war criminality. "When there's a genocide in Darfur," said Mr Obama, "these aren't simply African problems." "We will stand behind efforts to hold war criminals accountable," he said, without naming names. He failed to deplore the AU's reluctance to co-operate with the International Criminal Court at The Hague, where Mr Obama hopes Mr Bashir will be sent.

Mr Obama's administration may not yet have determined its policy towards Sudan. Several of his team, notably Susan Rice, his ambassador to the UN, and Samantha Power at the National Security Council, have in the past urged more robust action to deter Mr Bashir over Darfur. But Mr Obama's new envoy to the conflict zone, Scott Gration, is seeking diplomatic engagement. It was under Mr Bush's watch that a separate peace accord was hatched between the Sudanese government and a rebel movement in the south that may be offered the option of secession following a referendum promised for 2011. Mr Obama may well be called on to help sort out that mess if conflict breaks out again, as many fear, within the next year or so.

Another awkward area for him is Kenya, the land of his own forebears. Along with the Nigerians and the South Africans, who may get a visit by Mr Obama during next year's football World Cup, the Kenyans were sad to have been passed over. (His secretary of state, Hillary Clinton, is due to visit next month for a big trade meeting.) Mr Obama barely mentioned Kenya in a favourable light. For sure, he is aware that the current president, Mwai Kibaki, is widely thought to have stolen the presidential election a year-and-a-half ago from Raila Odinga, now prime minister in a floundering power-sharing government, who happens to hail from the same ethnic group as Mr Obama's father. Yet the country has long been an American ally in security matters in the region. Mr Obama's moment to try sorting out Kenya's many problems may come. But not yet.

The deeper truth is that Africa is not high on the American president's agenda. His Ghana speech was sensible and stirring. But in the end his message was that African-American relations would see no grand change.

Equatorial Guinea's durable president

Oil makes friends of us all

Jul 16th 2009
From The Economist print edition

Three decades at the helm isn't long, says a pitiful place's ruthless president

NEXT month Obiang Nguema will celebrate the 30th anniversary of his coup against his genocidal uncle, Macias Nguema. Since then he has shown a deft ability to stay put in the face of numerous coup attempts, bitter rivalry in his ruling clan of the Fang group, and efforts by foreign mercenaries to get rid of him. One of Africa's last "big men", he is the longest-serving leader south of the Sahara, since Gabon's Omar Bongo died last month. But he has barely benefited his 600,000-plus subjects.

The former Spanish colony struck oil in the 1990s and is sub-Saharan Africa's fourth-largest exporter after Angola, Nigeria and Sudan. Its people should be rich and happy, yet they are repressed and mostly poor. "It is the quintessential example of the oil curse," says Alex Vines of London's Royal Institute of International Affairs, who has written a damning report on the country for Human Rights Watch, a New York-based lobby. Last year Transparency International, which monitors graft from Berlin, ranked Equatorial Guinea as the world's ninth-most-corrupt country. Less than 2% of its GDP goes on public health and less than 1% on education. But President Nguema spends vast sums on defence, for example by hiring an American private security firm, Military Professional Resources, to train his army.

A sprightly 67-year-old who has regular health check-ups abroad, Mr Nguema says he has no plans to leave office. He is sure to be declared the winner, by a thumping margin, in a presidential poll scheduled for December. Last year his party won 99 of his parliament's 100 seats. His government runs the press and jails opponents. But things might be worse if Mr Nguema lost control of rival factions in his family. The main one is led by his elder son, Teodorin. If they were let loose, the scramble for oil money could easily turn violent.

Barack Obama shows no sign of dropping Mr Nguema as an ally of America, whose firms pump out much of the oil. China, which has built a big embassy in Malabo, the island capital, is cosying up too. And despite longstanding complaints about Mr Nguema's brutal ways, Spain has also been currying oily favour. Repsol, a Spanish firm with historic Equatorial links, says it is returning to the country after nearly 30 years. And Spain's foreign minister has just flown in to give Mr Nguema a friendly wink.

An election in Iraqi Kurdistan

Change in the air?

Jul 16th 2009 | SULAYMANIYAH
From The Economist print edition

A new movement is trying to break an old duopoly

AS IRAQ'S Kurds prepare to vote on July 25th for a regional assembly and a president, the buzzword is *Goran*, meaning change. It is also the name of a new movement that is trying to defeat—or at least to dent—the two parties that came into their own when the Kurds won self-rule in 1991, after the Americans and their allies chased Saddam Hussein out of Kuwait in the south and then prevented him from beating up the Kurds in the north. The elections promise to be the most hotly contested during the Kurds' current golden era of autonomy. As Change's campaign gathers pace, its name and logo, an orange candle on a dark-blue background, is emblazoned on buses, taxis, T-shirts, baseball caps and balloons. The movement is on a roll. Whether this translates into votes in a society where patronage and clan loyalties still largely hold sway is not yet clear.

Change says it wants to improve the lives of Kurds across the region. It castigates the corruption and cronyism of the two main parties: the Kurdistan Democratic Party (KDP), long a fief of the Barzani clan in the north and western parts of the region around Dohuk and Erbil; and the Patriotic Union of Kurdistan (PUK), run by the Talabani clan in Sulaymaniyah province to the east and in the disputed lands to the south around Kirkuk.

Change also says the two established parties have done a poor job at defending Kurdish interests in the federal parliament in Baghdad. Kirkuk, the fiercely disputed city and province which the Kurds claim as theirs, is still in administrative limbo; the Arabs who run the national government in partnership with the KDP and PUK refuse to let it go or hold a promised referendum, though the Kurds control most of the area. Change says it agrees with its Kurdish rivals on territorial goals but would be better at achieving them.

The KDP and PUK, which were once deadly foes but have shared power for the past four years, are running for the region's 111-seat assembly on a joint list. Also in the race is an odd alliance of moderate Islamist and secular parties. There are 24 lists in all, with 11 seats reserved for minorities such as Turkomans and Christians.

Change's leader is Nawshirwan Mustafa, aged 65, who for many years played second fiddle in the PUK to Jalal Talabani, now Iraq's national president. But two years ago Mr Mustafa broke away, saying that a KDP-PUK stranglehold over every aspect of life had bred corruption, cronyism and nepotism to the detriment of ordinary Kurds. A host of senior officials and thousands of PUK rank-and-file have followed Mr Mustafa; many have been expelled for sympathising with him.

Popularly known as Kak Nawshirwan (Kak being a term of respect for an elder brother), Mr Mustafa uses the Wusha Foundation, a media outfit that runs a daily newspaper, a popular website and a satellite TV station, to spread his message. "It's time for pluralism, accountability and transparency in Kurdistan," he says. "If we want to achieve our goals in Baghdad, we must sort out our own house first."

The old two-party establishment has responded by drafting in Barham Salih, a widely respected PUK man who is Iraq's deputy prime minister, to head its list. If the duopoly survives, he may replace the Kurdish region's incumbent prime minister, Nechirvan Barzani, a KDP man who is a nephew of the region's president, Masoud Barzani, the clan's undisputed leader. Under an agreement between the KDP and PUK, the prime minister's job was supposed to rotate every two years but turmoil in the PUK meant it failed to produce a candidate, so the younger Barzani has stayed put for four years. A row over the issue could

well break out after the election.

No one seems to think that the position of the senior Barzani is under threat as the region's top man. He heads the most powerful Kurdish clan unchallenged, as his father did before him. In a separate ballot on the same day as the assembly vote, Kurds are likely to re-elect him.

In general, they still appreciate the longest period of peace they have enjoyed for many years, especially compared with the continuing bloodshed farther south. Prosperity has grown. The infrastructure has improved. New oil wells are being sunk. But dissatisfaction with administrative shortcomings—in essence, corruption—has been growing too. If Change gets going, the old establishment may not last for ever.

Honour killings in Syria

The law changes. Will attitudes?

Jul 16th 2009
From The Economist print edition

Half way to stopping a nasty tradition

BASHAR ASSAD, Syria's president, has made it a bit harder for men to kill their daughters and sisters for the sake of "honour". The crime had previously carried no minimum sentence; the maximum was a year. Now, a presidential decree has made a small but significant change: honour-killers must face at least two years in prison.

It is still common, in Syria and throughout the Middle East, for men to murder female relatives deemed to have besmirched the family's moral standing—for example, if they have had sex outside marriage or wear immodest clothes. No one knows exactly how many women die in this way, because many cases go unreported. The United Nations Population Fund estimates that, across the world, as many as 5,000 women a year may be fatal victims.

The issue has been debated in Syria for some time. Last year the government gave the nod to a workshop that looked into changing the penal code. Those who debated the issue then called for a reform to Article 192, which lets judges waive or reduce the punishment for any crime motivated by honour. It also demanded the repeal of article 548, which exempts men from the usual sentences for murder and assault if provoked by "illegitimate sex acts" or "the suspicious state" of female relatives. Mr Assad was persuaded to change Article 548 but so far he has kept Article 192 intact.

Governments throughout the region have been loth to punish the perpetrators of honour crimes. In many countries, the penalty for this sort of killing is still softer than for other kinds. Jordan's parliament has repeatedly blocked a law that would impose harsher penalties on men who kill their female relatives for the sake of honour; the lawmakers say it would encourage adultery. Despite campaigns by local lobbies and charities, the penal code in Lebanon still imposes lighter sentences for crimes of honour.

While praising the Syrian amendment, human-rights advocates point out that the law in Syria and elsewhere still accepts the basic notion that you can kill for honour, and argue for a more fundamental change in the attitudes of those who write the law and implement it.

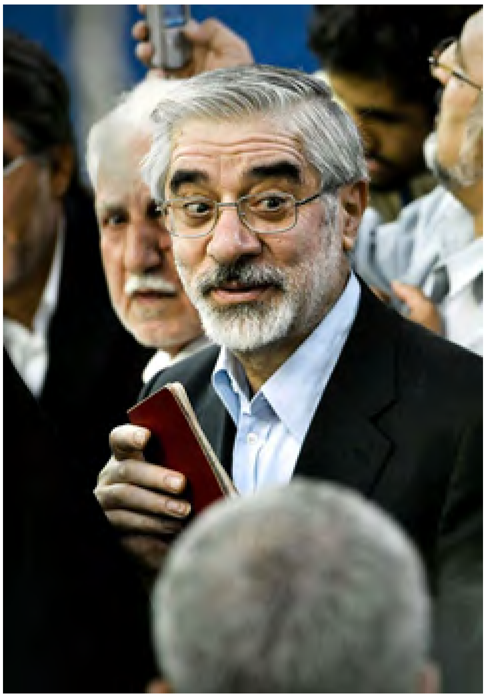
Iran's Mir Hosein Mousavi

Out of his shell

Jul 16th 2009
From The Economist print edition

The thwarted presidential challenger is refusing to give up

Eyevine



Mousavi won’t be muzzled

MIR HOSEIN MOUSAVI has been virtually incarcerated in his home in Tehran since huge demonstrations in his favour began to die down a few weeks ago. But the game is not yet over. He is still refusing to obey the country’s supreme leader, Ayatollah Ali Khamenei, despite his orders to accept defeat at the hands of the incumbent president, Mahmoud Ahmadinejad, and to help quell protests, which have anyway got a lot smaller and less frequent. This week, in spite of lying fairly low for some time, Mr Mousavi seemed as determined as ever not to go quietly. Indeed, he may once more be coming out of his shell—and back into the public maelstrom.

Two strong factors are still working in his favour: a divided clerical establishment and the blogosphere, where Iranians are among the world’s liveliest performers. On his own website, the frustrated challenger is still calling for the election to be run again. He says Iran’s detainees should be freed, the election law reformed, and the state’s broadcasting monopoly broken up. He calls his ideology the *mowj-e sewon* or “third way”.

Framed in glowing green, the colour enthusiastically adopted by the government’s foes, Mr Mousavi’s website shows him beaming, shoulder to shoulder, alongside Muhammad Khatami, a former reformist president who preceded Mr Ahmadinejad and who has also come out in opposition to him. The site’s mantra is change and progress. It also makes much of Mr Mousavi’s go-ahead wife, Zahra Rahnavard, the first woman in Iran to become the chancellor of a university. She was controversially seen during the campaign holding hands with her husband in public.

Mr Mousavi also features on Facebook, where he alerts people to his activities. This week, it notes, he is expected to attend Friday prayers, led by another prominent opponent of Mr Ahmadinejad, Akbar Hashemi Rafsanjani, yet another former president: he has emerged as perhaps the most powerful critic of the embattled ruling establishment. Mr Mousavi and his wife have also been shown on Facebook visiting the parents of a young man, Sohrab Aarabi, who has become a symbol of protest since his family took on the authorities when they at first failed to give his body back after he was killed in a demonstration.

Now propelled by a vanguard of protesting students and disgruntled clerics, Mr Mousavi, once a leading light in the Islamist revolution against the shah in 1979, may have taken a more radical line than he intended when he decided to run for president. But the fiddling of the election and its violent aftermath seems to have swept him up.

The waves of anger and dissent that have rolled across the land, especially among young people and women, have plainly not been confined to the middle-class suburbs of northern Tehran. This week Mr Mousavi’s senior aide, Ali-Reza Beheshti, himself the son of a famous clergyman, said that Messrs Mousavi and Rafsanjani may form a political front.

The other factor that may sustain Mr Mousavi is growing disarray in the ranks of senior clergy who have hitherto underpinned the Islamist regime. While not directly criticising Mr Khamenei or his conservative inner circle, several scholars at the pinnacle of the Shia establishment have publicly scolded the authorities for mishandling the election and its aftermath—and have directly or by implication backed Mr Mousavi.

Grand Ayatollah Abdolkarim Mousavi Ardabili was the first prominent one to break ranks by apparently telling the Guardian Council, the powerful body overseeing elections, that people had a "right to be heard". Another grand ayatollah, Asadollah Bayat Zanjani, added his voice, describing the protests as "a lawful right of the people and their only way to put requests to their rulers".

This month Grand Ayatollah Yusef Sanei, a long-disgruntled reformist who once headed the Guardian Council, said there was no justification for "suppressing" people's rights; the much-publicised confessions of jailed demonstrators had no legal standing, he added, as they had obviously been illegally obtained. Yet another notably discordant voice belongs to Hosein Ali Montazeri, who long ago fell out with the authorities after being dropped as the nominated successor to Ayatollah Ruhollah Khomeini, the founding supreme leader, who died in 1989. Mr Montazeri has recently come out for Mr Mousavi and the reformists, saying that a failure to allow peaceful gatherings could "uproot the very foundations of government".

Such clerical support—there are only a score or so of grand ayatollahs—must hearten Mr Mousavi and rattle Mr Khamenei and his protégé, Mr Ahmadinejad. After all, Mr Mousavi had been in the wilderness for two decades since falling out with Mr Khamenei. During that time, he indulged his passion for painting and architecture. He became president of Iran's Academy of Arts but kept out of politics.

Now he will have to muster a lot of courage to stay firm. On his website he darkly mentions unspecified "pressures" that the authorities are quietly exerting on him to give up. Hundreds of dissenters are still behind bars. The recent reported hanging this week of 13 or 14 members of a Sunni group in south-eastern Iran called the Jundullah, which the authorities bizarrely accuse of having links with both al-Qaeda and the West, may be a way of warning protesters that the regime may yet become even more ruthless in squashing dissent.

The Arabs' view of Iran

Mixed feelings

Jul 16th 2009 | CAIRO
From The Economist print edition

Most Arab governments are queasy but the people feel more ambivalent

AS PUBLIC protest in Tehran seems to dwindle, at any rate on the streets, many Arab leaders are quietly exhaling a sigh of relief. At first, a lot of them were quite chuffed by the sight of turmoil in Iran, since they have long felt edgy about their big neighbour's rising ambition and influence in the region. But as time passed they began to feel queasier: the prospect of revolution in the streets, albeit those of a rival power, is not something most Arab regimes, wedded to the status quo at home, truly welcome.

Arab governments, like most others, had expected Mahmoud Ahmadinejad to be easily re-elected as Iran's president. For regimes that oppose Iran and worry about its support for radical Arab groups such as Hizbullah in Lebanon or Hamas in the Palestinian territories, Mr Ahmadinejad's continuing tenure seemed happily to guarantee more bad blood between Iran and the United States. A number of conservative Arab leaders are worried that Barack Obama's apparent eagerness to re-engage with Iran could increase its clout in the region, to the detriment of moderate Arabs.

Leading this camp are the leaders of Egypt and Saudi Arabia. The Saudis and their Sunni royal family also fear that the Iranians will stir up the large Shia minority in their oil-rich Dhahran province in the east. In the past few years the Saudi and Egyptian governments have occasionally let their media descend into anti-Shia bigotry and old-fashioned Persia-bashing.

But their officials have generally stayed silent, resisting the temptation to tweak the noses of the ruling clergy in Tehran, since they rail against interference from outside when it comes to their own politics. But they have been quite happy to let the state media ridicule Mr Ahmadinejad.

On the other side are Syria and the rich little Gulf state of Qatar, which sympathise with Iran's regime, help Hamas and Hizbullah, and welcome Mr Ahmadinejad's re-election. After an initial period of awkward silence, when they said the "democratic process" should take its course, they have often resorted to mocking Arab calls for democracy in Iran. Qatar's emir, Sheikh Khalifa bin Hamad al-Thani, who deposed his father in a coup in 1995, quipped that "Iran has had four presidents since its revolution, while some Arab countries have not changed their leaders at all."

Indeed, among Arab republics, only Algeria and Lebanon have had as many recent heads of state as Iran. Many ordinary Arabs know this—and have felt confused about whether or not to side with Iran's street protesters. They tend to admire Mr Ahmadinejad's fierce hostility to America and Israel, and are ashamed of their own governments' far more pliable attitudes on that score. They also tend to believe official Iranian claims that American and Western agents have been trying to stir up a "colour revolution" in Iran. Yet, as they saw the pictures of hundreds of thousands of people taking to the street, they will have been envious too. However flawed Iran's version of democracy, it still looks more a lot more real than the typical Arab one.

Energy in Europe

He who pays for the pipelines calls the tune

Jul 16th 2009
From The Economist print edition

Nabucco and other new gas pipelines may make Europe's energy more secure, but market liberalisation matters too

TRAGEDY and farce have too often been the hallmarks of European efforts to improve energy security. Dependence on Russia, which supplied a third of its gas imports through Kremlin-controlled east-west pipelines, seemed to be rising inexorably and worryingly. Squabbling between Russia and Ukraine led to repeated supply cuts. The Russians exploited energy to divide and rule their Western neighbours. Big energy companies in countries such as Germany and Austria sought cosy relations with Russia's state-controlled gas giant, Gazprom.

The overlap between politics and profit was epitomised by Gerhard Schröder, a former German chancellor. Since 2005 he has been the front man for Nord Stream, the pipeline that is planned to run under the Baltic. Along with South Stream, a sister project across the Black Sea, Nord Stream would let Russia bypass troublesome transit countries, chiefly Ukraine. West European customers could benefit, but the plans alarm countries in the east that are at greater risk of Russian bullying.

Now this gloomy picture is brightening. For a start, Europe has diversified its sources of supply: cost and unreliability have led Gazprom to lose a third of its European market to imports from Norway, Qatar and Trinidad, says Mikhail Korchemkin of East European Gas Analysis, a consultancy. Second, one of the European Union's efforts to curb Russia's transit monopoly is gaining traction. In a signing ceremony in Ankara on July 13th, the Nabucco pipeline, which will connect Europe to gas-rich Central Asia via the Balkans, Turkey and the Caucasus, won formal backing from the main transit countries: Austria, Hungary, Romania, Bulgaria and Turkey, as well as from Germany.

This step reflects a €200m ($283m) dollop of EU money, plus some political shifts. Turkey had earlier bargained toughly (some said destructively). The EU's quiet expression of interest earlier this year in White Stream, a rival project across the Black Sea, may have changed Turkish minds. And Nabucco has

hired Joschka Fischer, a former German foreign minister, as a consultant (see article).

Eyevine

Nabucco could carry some 30 billion cubic metres of gas a year. But that is only a fifth of what Russia exports to Europe; and it will not be finished until at least 2015. Moreover, the sources of that gas remain unclear. Azerbaijan has enough only for the project's early stages, though it is exploiting new offshore gasfields. Iran would be a logical supplier, but is out of the question on political grounds. A promising newcomer is Iraq's Kurdish region. In May a Western-backed consortium unveiled an $8 billion plan to extract gas there and sell it to Nabucco. This week Nouri al-Maliki, Iraq's prime minister, said he could supply half the gas the pipeline needed.

But the biggest prize would be gas from Turkmenistan, a Central Asian dictatorship that claims to sit atop one of the world's largest gas reserves. The Turkmen leadership is hesitant about annoying the Kremlin, which now buys all of the country's exports to make up for Russia's own flagging gas production. But an EU-backed negotiating consortium has made some progress in talks with Turkmenistan. President Gurbanguly Berdymukhammedov recently announced that his country had a surplus of natural gas "available to foreign customers, including Nabucco".

That would, however, require a new pipeline under the Caspian Sea, which would not only be costly and slow but also subject to objections from Russia and Iran (which would like to offer a land-based route instead). Russia is the only serious naval power in the Caspian. It showed in last August's war with Georgia that it is prepared to use military force to protect its interests in the neighbourhood.

An American delegation, including Barack Obama's national security adviser on the region, Michael McFaul, has just been to Turkmenistan to stress the importance the West puts on making Nabucco a success. American lobbying proved crucial to the success of the Baku-Tbilisi-Ceyhan oil pipeline that runs from Azerbaijan to Turkey's Mediterranean coast, which opened in 2005. Many thought that was a pipe dream in the beginning, but with strong political backing it came to acquire an aura of inevitability. Nabucco's backers hope to repeat the BTC pipeline's trick.

Other less ambitious pipelines are also moving ahead. ITGI, which aims to bring Azeri gas to Italy via Turkey and Greece, has just announced a deal to extend a spur north to Bulgaria, ending that country's near-total reliance on Russian gas. Another EU-backed scheme, the Trans-Adriatic Pipeline, has signed up gas from Iran and expects to draw on Azerbaijan too.

Russia has not given up. Gazprom has just signed a $2.5 billion deal with Nigeria (it was named Nigaz, showing a refreshing ignorance of politically incorrect language). It is pressing on with the Opal pipeline to connect Nord Stream to an existing transit point on the German-Czech border. Germany, controversially, has given the scheme a 25-year monopoly. But other bits of the Kremlin's energy diplomacy show patchy results. Attempts to build an international gas cartel have stalled. Plans for a push into liquefied natural gas look unrealistic. Most recently, a row with Turkmenistan has hit Russia's gas imports.

Corruption, incompetence and state interference have long held back Russia's gas industry. Production is falling. Russia has brought only one new gasfield on stream since the collapse of the Soviet Union and new reserves are in costly, distant regions. Even before the oil price fell (bringing down the gas price too), Gazprom had the highest costs and worst finances of any international gas company. With debts of over $40 billion, it will struggle to afford projects that make political sense, but cannot pay their way. That is how Nord Stream (cost up to €13 billion) and South Stream (€20 billion) increasingly look. Alan Riley, a British academic specialising in competition law, thinks both projects may also breach EU anti-monopoly rules.

That is a more serious threat as EU energy-market liberalisation takes hold. So far Germany, France and others have fought to protect national energy champions. But the European Commission wants more liberalisation and better interconnections. On July 8th it fined two energy giants, Germany's E.ON and GDF Suez of France, €553m apiece for a market-sharing agreement involving Russian gas. It may yet look into whether Gazprom's Opal monopoly and its contract bans on re-export of gas are legal. "The commission is trying to achieve through litigation what it couldn't achieve through legislation," says Pierre Noël, a French

energy analyst at the European Council on Foreign Relations. Boring energy liberalisation may be a surer route to energy security than glamorous pipelines.

German politicians and pipelines

Joschka Fischer v Gerhard Schröder

Jul 16th 2009 | BERLIN
From The Economist print edition

Germany's odd couple square up over their country's stance on Russia

AP

Holding noses before jumping ship

EVEN in power they were an odd couple: a Social Democrat who steered through painful economic reforms and a Green who sent German troops into their first foreign war since 1945. Out of power, the tribal loyalties of Gerhard Schröder, Germany's previous chancellor, and Joschka Fischer, his foreign minister, have now re-emerged. The two are at opposite ends of a furious debate over energy security and relations with Russia.

The haste with which Mr Schröder hopped from the chancellery to chair the shareholders' committee of the Nord Stream pipeline, planned to run on the Baltic seabed, reflects both his own views (he once called Vladimir Putin a "flawless democrat") and his party's longstanding policies. Ever since Chancellor Willy Brandt came up with the notion, the Social Democratic Party (SPD) has been wedded to *Ostpolitik*. So much so that it survived unification and is now the party's policy towards Russia.

The argument is that Russia needs European markets as much as the European Union needs Russian gas. "Germany's strategic interest is to bind Russia into an energy alliance with the EU," says Alexander Rahr, an analyst at the German Council on Foreign Relations (DGAP). "They are more dependent on us than we are on them." The pitfall is that the SPD tends to be soft in its criticism of Russia over human rights and other issues—look at the behaviour of the present SPD foreign minister, Frank-Walter Steinmeier. There is also a fear that, by binding in Russia, Germany may be binding itself. Imports of Russian gas are expected to rise to almost half the total, from 40% now.

Pitted against both Mr Schröder and the SPD view is Mr Fischer, who has lent his support to the Nabucco pipeline, which would give the EU an alternative to Russian gas. This too is in character. Mr Fischer has long been critical of Russia, especially on human rights. He was also more vocal than Mr Schröder in backing Turkey's entry into the EU. Mr Fischer's presence is seen not only as a way of maintaining the support of Turkey and its neighbours for Nabucco; it also points to a shift in the German debate over whether energy security is better established by going it alone or by working with the rest of the EU.

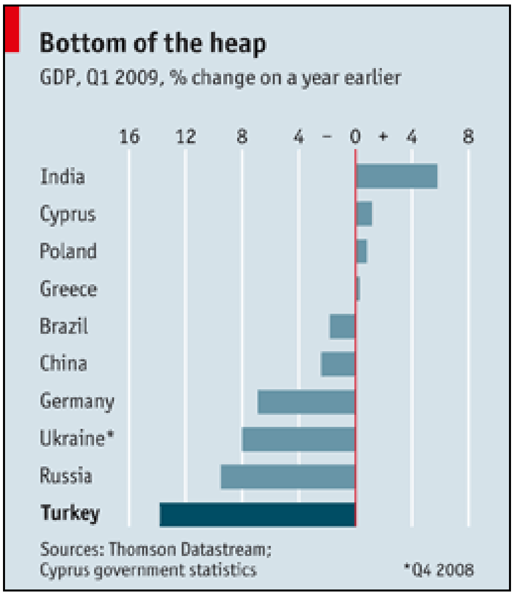
Germany has always professed EU solidarity on energy, but its actions have often suggested the opposite. It has resisted further energy liberalisation, to protect its own energy giants. Its support for Nord Stream has enraged some eastern neighbours. Yet nerves were rattled this year when a dispute between Russia and Ukraine cut off the gas to the EU. Instead of going it alone, Germany is now hedging its bets, by supporting pipelines that go both from and around Russia.

Turkey's fragile economy

Fund management

Jul 16th 2009 | ISTANBUL
From The Economist print edition

The economy may soon recover, but Turkey still needs an IMF deal



ALONG the Bosporus in Istanbul, the deluxe restaurants and discos are packed and the mood is decidedly upbeat as the glitterati down champagne and belly-dance the night away. They seem unfazed by a stream of bad news about the Turkish economy. Figures released this week show that the budget deficit increased thirteenfold in the first six months of 2009. Foreign investment fell by half in the first five months of the year. One in four youths are now unemployed. To crown it all, GDP shrank by a record 13.8% in the year to the first quarter, putting Turkey among the economies worst hit by the global recession (see chart). The IMF expects the economy to contract by 5.1% this year, after registering average annual growth of 6% in the past six years.

When the global financial storm struck in the autumn of 2008, Recep Tayyip Erdogan, the prime minister, boasted that “the crisis has bypassed Turkey”. He also claimed that there was no need for his country to renew a standby deal with the IMF that expired in May 2008. He has since been forced to eat his words. “We do not have a full-blown crisis, but everything has got significantly worse,” says a Western economist in Istanbul. No wonder Mr Erdogan has now begun to talk of doing a deal with the IMF after all.

Yet in many ways Turkey has weathered the credit crunch better than other emerging economies. Partly thanks to tough regulation, not a single Turkish bank has gone under. That is also because, unlike many Western banks, they have few toxic assets and limited mortgage exposure. So the government has not had to divert public money into rescuing banks. Predictions that Turkish companies that borrowed heavily abroad would fail to roll over their debt after the lira lost a third of its value have also proved wrong.

Western bankers are pleased with the new economic team formed after the cabinet reshuffle in early May. The former economy minister, Mehmet Simsek, is now in charge of finance. His predecessor, Ali Babacan, has switched from the foreign ministry to become an economy tsar with co-ordinating authority over all finance and economy portfolios. Mr Babacan carries weight with Mr Erdogan. Both he and the market-friendly Mr Simsek are known to favour a new agreement with the IMF, which is crucial to retaining the confidence of foreign investors. According to the bankers, a $13 billion 18-month standby facility is in the works, though some think that Turkey may need at least $20 billion to service its foreign debt.

The main snag, say people close to the talks, is Mr Erdogan’s reluctance to go along with the IMF’s fiscal demands. These include improving tax collection by unifying the different agencies under a single roof. The IMF also wants to see the adoption of fiscal rules to monitor public spending independently, as well as a reduction in funds transferred to local municipalities that are often used to buy votes. A final agreement is unlikely before October, when parliament reconvenes. Coincidentally, that is also when the IMF and the World Bank hold their annual meetings in Istanbul.

Yet despite the terrible first quarter, some economists believe that Turkey’s economy is robust enough to survive without help from the IMF. A recent forecast by Merrill Lynch shows GDP growing by an average of 4.5% between 2010 and 2019. If inflation is successfully kept down, this could rise to an average of 5.5%.

One of the perennial problems that helped to cause Turkey’s past economic crashes was political instability. That has largely gone since Mr Erdogan’s mildly Islamist Justice and Development (AK) Party shot to single-party rule in 2002. Indeed, its relatively successful management of the economy is one

reason why AK was re-elected with an even bigger share of the vote in 2007. With March’s municipal elections now behind him, Mr Erdogan badly needs to revert to fiscal discipline. And that might be easier to do if the IMF is publicly seen to be involved.

Silvio Berlusconi's success

In heaven or hell

Jul 16th 2009 | L'AQUILA
From The Economist print edition

Italy's prime minister once again proves to be a great survivor

EPA

Berlusconi, on top of the world

DEPENDING on your view of his final destination, Silvio Berlusconi has either a guardian angel or the luck of the devil. Before the G8 summit in L'Aquila, aides portrayed a man staring into the abyss. Rumours were rife of a new compromising batch of photographs showing Italy's prime minister cavorting with "escorts". L'Aquila was being hit by aftershocks from the April earthquake that led Mr Berlusconi to move the summit there. Given another tremor of over four points, it would have been cancelled or moved again. There was such a tremor—but two days after the summit. The spicy photographs, if they exist, remain unpublished. The outcome of the summit reportedly left Mr Berlusconi euphoric.

It also left a question that has nagged many foreign observers ever since his third election win last year: why do so many Italians want as their leader a man whom *L'Express*, a French magazine, recently called "the buffoon of Europe"? His stranglehold on Italy's media does not give the whole answer (though it supplies part: television news has paid scant attention to an inquiry by prosecutors into the alleged procurement of women for Mr Berlusconi's parties).

Voters may have had other motives. Many were appalled by the disunity of the previous, centre-left government. Plenty liked the right's law-and-order platform. Some were wooed by his mastery of political communication. And even his failings—his vanity, outrageous quips and alleged promiscuity—often elicit more empathy than censure from ordinary Italians.

But there is a further explanation, rarely mentioned, which recent events have brought to the fore: that many voters, including some critics of Mr Berlusconi, see him as soft on tax evasion and so vote for him out of self-interest. Supporters of this theory often point to the unreliability of Italian exit polls, which produce results skewed leftward. Some people who vote for Mr Berlusconi's party lie to pollsters because they feel ashamed.

Tax fraud was one of the charges against Mr Berlusconi in a trial that was suspended last year when his government passed a law to give him immunity. But though clamping down on tax dodgers was not a priority of his 2001-06 government, it is a stated aim of this one (the treasury needs revenue to stop the budget deficit exploding). Not surprisingly, criticism was voiced this week when details trickled out of a "fiscal shield" for repatriating funds salted away by Italians in tax havens. Reports suggest that it could bring in over €3 billion ($4.2 billion). But it will be the third tax amnesty by a Berlusconi government in eight years; and beneficiaries will pay tax up to a maximum of only 5% on their newly declared assets.

The Berlusconi government had already quietly made a string of changes that critics say will make tax evasion harder to detect among the self-employed, professionals and small-business owners. A study published on *La Voce*, a website, by two academic economists, Silvia Giannini and Maria Cecilia Guerra, argues that they amount to a "non-belligerence pact". They point to a halt in collection by investigators of some forms of digitally stored information; the suppression of an obligation on small businesses to supply lists of clients and suppliers; and the abolition of restrictions on the use of cash. Putative evaders have also been given the chance to pay a fine equivalent to only 12.5% of unpaid tax in return for immediate co-operation. That may speed collection, but it also raises the risk-reward ratio of evasion.

The Bank of Italy said this week that state revenues fell by more than 3% in the first five months of 2009. It is too early to say if this is due to slacker compliance, but Professor Giannini says that in late 2008 there was a suspicious mismatch between a fall in VAT receipts and a smaller drop in consumption. In

another paper, she and her co-author note that among those who may not have paid their share are the escorts reportedly given €1,000-2,000 for visits to Mr Berlusconi's Rome residence. If they were VAT-registered, the paper notes, "they should have issued a proper invoice and charged the customer VAT at 20%".

Russia's north Caucasus

A mountain of troubles

Jul 16th 2009 | MOSCOW
From The Economist print edition

The north Caucasus continues to suffer kidnappings, torture and killings on a horrifying scale

AFP

A day in the life of Ingushetia

ON JULY 7th, as Barack Obama and Dmitry Medvedev discussed world security in the Kremlin, people charged with security in Chechnya kidnapped a local man and his son. Twelve hours later the man was dragged from a car in his underwear and executed before a few villagers. And this was but one of many punitive actions taken by Chechen authorities against relatives of alleged rebels.

It was brought to light by Natalia Estemirova, a human-rights activist who has chronicled kidnappings, torture and killings for a decade on behalf of Memorial, Russia's oldest human-rights group. Ms Estemirova received prizes in Europe, but no thanks from her government. On July 15th, as she left home in Chechnya, she herself was kidnapped. A few hours later she was found dead in neighbouring Ingushetia. Her hands were tied and she had two bullets in her head and chest.

Ms Estemirova's murder topped the headlines of foreign television networks, but was mentioned only in passing by Russian channels, despite a prompt condemnation from Mr Medvedev. Her colleagues say that her work had outraged Ramzan Kadyrov, Chechnya's president. They blame him for her murder (though Mr Kadyrov pledged to lead the investigation into her murder himself).

Chechnya is no longer considered a "zone of a counter-terrorist operation". This status was removed a few months ago at the request of Mr Kadyrov. Since then the number of disappearances, house burnings and killings has risen. Even before Ms Estemirova's murder, Ekaterina Sokiryanskaya, a colleague, talked of escalating fear in the region and pressure on human-rights activists. "Natalia [Estemirova], who tried to fight the victims' cases, was braver than many of the relatives," she said after the murder. Fear and force have been Mr Kadyrov's main tools of governance. As a former rebel, he has coerced those who fought alongside him and got rid of those who opposed him. He has turned Chechnya into his fief, more Russia's ally than its subject.

Across the region, killings and kidnappings have become common. Ingushetia has descended into what amounts to a civil war, says Grigory Shvedov of Caucasian Knot, an independent news service. The killing of policemen has become systematic. In an especially daring attack on June 22nd, rebels used a suicide-bomber to try to kill Yunus-Bek Yevkurov, Ingushetia's president. His driver and a bodyguard were killed; he is still in hospital. A Chechen group involved in the Beslan school siege in 2004 took responsibility and its leader promised more attacks. Nobody knows how many rebels there are in Ingushetia or neighbouring Dagestan. Many are local and young, born when Russia first went to war in Chechnya in 1994, says Mr Shvedov.

Russia's brutal repression and lawlessness have pushed people towards Islamic fundamentalism. The rebels are now driven not by ideas of independence but by revenge or the vision of an Islamist state. Their influence has become especially visible in Ingushetia. "People are afraid to go out in the evening, cafés are closed, there are fire exchanges almost every night," says Ms Sokiryanskaya.

Mr Yevkurov, a paratrooper, inherited a corrupt and weak government from his predecessor, a KGB general named Murat Zyazikov. His first steps were encouraging: he unearthed corruption, engaged with opposition leaders and began to fight against armed rebels. He also insisted that Russia's federal forces should not carry out "special operations" in Ingushetia without his knowledge. But this has had little effect, says Ms Sokiryanskaya. "They simply do not know any other way," she explains.

The Kremlin likes to blame Western security services for destabilising the region. Some Russian security men also blame Georgia's president, Mikheil Saakashvili. "For as long as people like Saakashvili—the neo-Nazis and neo-Führers—lead neighbouring states, we will not be in peace," Arkady Yedelev, Russia's deputy interior minister, said recently.

Russia's large-scale "Caucasus 2009" military manoeuvres were held under the banner of fighting terrorism. Mr Medvedev, who inspected the Russian units, explicitly linked the exercises to last year's war in Georgia. "The main lesson for us from these events is the necessity to hold fully fledged, ongoing and highly effective exercises," he said this week, a day after visiting South Ossetia, which Russia (almost alone) recognises as independent. This came only a few days after Mr Obama said that America recognises Georgia's territorial integrity and does not want a renewal of military conflict. To ram that message home, an American warship arrived in Georgia this week to hold the first joint exercise since the end of last August's war. Joe Biden, America's vice-president, is expected to visit Tbilisi shortly.

The south Caucasus remains so tense that the European Union has delayed its report into the origins of the Georgia war, which was to have been published at the end of July. But even as the world's attention is fixed on Georgia, Russian citizens keep dying in the north Caucasus. Vladimir Putin, Russia's prime minister, once promised to hang Mr Saakashvili "by the balls". Sadly he seems to have no such feeling for those who killed Ms Estemirova.

Charlemagne

Playing the parliamentary game

Jul 16th 2009
From The Economist print edition

Its opening session reveals many flaws in the new European Parliament

Illustration by Peter Schrank

PERHAPS it was the threat of rain. Perhaps it was the location: a car park in front of the European Parliament in Strasbourg. At all events, there was something downbeat about the ceremony held on July 13th to start a new five-year parliamentary session. Some reports called it "militaristic", but that is too flattering. Before a sparse crowd, unarmed soldiers from the five-country Eurocorps hoisted the European flag. A children's choir sang the "Ode to Joy", the European anthem. The children had to compete with MEPs from the United Kingdom Independence Party, who started singing "God Save the Queen". This was meant to display British defiance but ended up sounding rude, which is not the same thing. It was all a bit depressing.

As a work in progress, the parliament invents its own flummery. This ceremony was supposed to mark 30 years of direct elections. But the pomp skirted round such awkwardnesses as the travelling circus between Brussels and Strasbourg, and the fact that average turnout has dropped at every election since 1979.

The world view of MEPs revolves around their direct election, which marks them out from rival European Union institutions. Because the parliament is democratic, goes the theory, when it accrues more power the EU itself becomes more democratic. This line has served MEPs well. Their powers have grown with every treaty, and will increase again if the Lisbon treaty is ratified.

Yet the parliament's claims to legitimacy are being questioned as rarely before, and not just because of low turnout. On June 30th, in its ruling on the legality of the Lisbon treaty, Germany's constitutional court declared that the parliament enjoyed only a second-class form of democratic legitimacy when compared with national parliaments. A new law must now be passed to give the German parliament greater EU oversight. The judges found two structural flaws in the Strasbourg assembly. First, voters are not equal: under Lisbon, a Maltese MEP will represent only 67,000 voters, a Swedish MEP 455,000, but a German MEP 857,000. Second, the court frets that the parliament "is not a responsive democracy", says Frank Schorkopf, a German constitutional law professor and former aide to the judge who wrote the ruling. Because the parties clump together in big coalitions that haggle with national governments and the European Commission, ordinary folk do not know how to vote if they want to influence EU laws. The ruling is a "heavy blow" to the European Parliament, concludes Mr Schorkopf.

Yet only a fortnight later, MEPs appeared set on showing that the parliament is a world unto itself. On its

opening day, leaders of the three biggest groups—from the centre-right, centre-left and liberal centre—announced a "technical agreement" to share out the job of the parliament's president. In theory, a secret ballot still had to be held, but the leaders were able to announce the winner in advance: a Polish former prime minister from the centre-right, Jerzy Buzek. After two-and-a-half years, Mr Buzek will be replaced by an MEP from the centre-left.

The group leaders also leaked word of another compromise, to vote on the re-election of José Manuel Barroso as president of the European Commission at their next plenary in September. How that might work is less clear. Mr Barroso is from the centre-right, and his camp wanted a vote in July with a broad base of support. The left and centre can thwart that, but not install a rival. So they are indulging in the political equivalent of bossnapping, taking Mr Barroso's second term hostage to demand impossible concessions. One MEP predicts an "institutional impasse" if Mr Barroso is not approved in September. He is the only candidate: if he is rejected, nobody knows what will happen next.

On the face of it, this horse-trading is odd (though stitch-ups of the parliamentary presidency are quite normal). After all, liberal and centre-right politicians spent the recent European elections calling each other dangerous and wrongheaded. Centre-left parties did so badly that it is easy for centre-right MEPs and liberals to muster a simple majority on their own most of the time. Yet the tendency is for all three to vote together.

The circling vultures

The key to the mystery is power. The group leaders said that their technical agreement was intended to "guarantee the stability" of the parliament as the "deepest expression of European democracy and integration". That gobbledygook is code for something different: a wish to maximise the parliament's clout in future fights with the commission and the 27 national governments.

By banding together, the three biggest groups can wield an absolute majority of votes in the 736-strong parliament. An absolute majority is needed if the parliament wants to rewrite laws against the combined wishes of the commission and national governments. And nothing excites most MEPs more than defeating the other institutions.

In the minds of many, such a tripartite pact is also code for marginalising the British Conservatives, now that the Tories have formed a new antifederalist group, the "European Conservatives and Reformists", with a band of mostly east European allies. The group had a bumpy start. On July 14th a veteran pro-European Conservative was expelled from the group after he snaffled a parliamentary vice-presidency that had been promised to a Polish colleague, Michal Kaminski. Mr Kaminski was promptly given the new group's leadership as a consolation prize.

The Conservatives will still be sought after in votes. But most MEPs, especially on the centre-right, want the new group to fall apart and are hoping to pick them off one by one. "The vultures are out there, sitting on the wall," says Geoffrey van Orden, a Tory MEP. And the voters? They will be consulted again in five years' time. Their opinions may, or may not, be taken into account.

Economist.com/blogs/charlemagne

Rising youth unemployment

No way to start out in life

Jul 16th 2009
From The Economist print edition

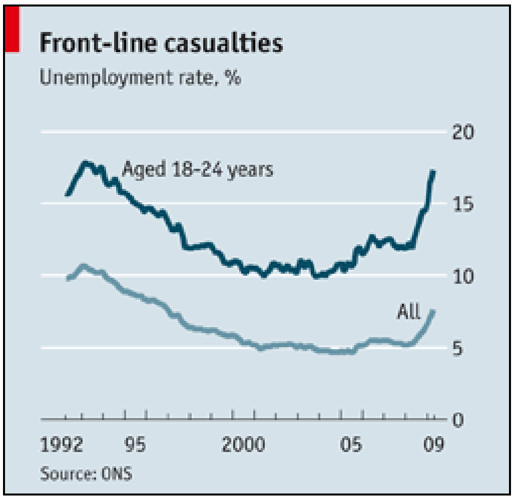
Report Digital

The plight of the young jobless calls into question Labour's record

THE human cost of the recession is felt most keenly by the unemployed. That cost, already high and rising, is steepest of all for young people who cannot find work. They are emerging as the prime victims of the slump.

The overall unemployment rate rose to 7.6% of the labour force during the three months to May, according to official figures published on July 15th. A year earlier it stood at just 5.2%. The total number of jobless is now close to 2.4m after increasing by a record 281,000 over the previous quarter, the three months to February.

This dramatic resurgence of unemployment is unwinding the clock. The jobless rate is now the highest since the end of 1996, six months before Labour won power. Even more worrying, the rate of unemployment among young people aged 18-24 has jumped from 11.9% to 17.3% over the past year. Not since 1993, in the aftermath of the previous and less savage recession, has it been higher (see chart). Indeed, the total number of unemployed youngsters aged 16-24 has now reached 928,000, up by 108,000 since the previous quarter ending in February. If it carries on rising at this pace there will be more than a million jobless young people later this year.



Young people typically find it hard to get established in the labour market because of their lack of experience, which makes them especially vulnerable in downturns. But even before the recession Britain's youngsters had been faring worse than their counterparts elsewhere. Between 1998 and 2005, the jobless rate for 16-24-year-olds in Britain was lower than the average for the OECD, a club of mainly rich countries, but since then it has been higher. The unemployment gap between that age group and 25-54-year-olds widened from 2004 to 2007 in Britain while staying broadly the same across the OECD.

The timing of the deterioration points to two possible explanations. A commonly held view is that British youngsters have been displaced by the influx of youthful migrants from eastern Europe since 2004. But this is the "lump-of-labour" fallacy—that a job for a Polish cleaner means one fewer for a native worker. Research by Sara Lemos, an economist at Leicester University, and Jonathan Portes of the Department for Work and Pensions last year found that the wave of migration had not increased youth unemployment.

A more likely explanation, though still disputed, is that the minimum wage was pushed up too much a few years ago. When it was introduced in April 1999, the main rate was set at £3.60 ($5.80) an hour, a fairly modest amount. There was a lower floor of £3 for 18-21-year-olds, because young workers' chances in the labour market were recognised to be especially sensitive to pay.

Since then, however, both rates have risen by 59% and outstripped average earnings, which have gone up by 45% in the past ten years. The increases were particularly big in the four years to 2006, adding to the suspicion that the minimum wage was implicated in the rising rate of youth unemployment over that period. The Low Pay Commission, the quango which sets the floor wage, contests this notion, but has been raising it at a more moderate pace in the past couple of years.

Where there is more general agreement is that the young people who are most vulnerable in the labour market are the low-skilled. Even when the economy was doing well in the middle of this decade, only 45% of children leaving school without a qualification such as five good GCSEs were employed a year later. Now relatively unskilled youngsters are bearing the brunt of the recession. Not only are young people more likely than older workers to be made redundant, but those with no or poor qualifications are much more likely to be sacked than graduates.

The government is trying to prevent a drift into long-term unemployment. Employers can now get a subsidy of £1,000 ($1,640) if they recruit someone who has been out of work for at least six months. And from the start of next year, any young person who has been jobless for a year or more will be guaranteed a job or training.

But the surge in youth unemployment is doubly embarrassing for Labour. Getting young people off benefit and into work was one of the party's five main pledges in the 1997 general election. The link between poor skills and joblessness also casts a harsh light on the government's record in education. Despite big spending increases and reams of new initiatives, far too many children still leave school with poor exam grades, undermining their job prospects at the best of times.

Young people are not the only losers from the recession, of course. A report this week from PWC, an accountancy firm, pointed out that people approaching retirement have also suffered a big blow in the falling value of houses and equities. But the plight of the jobless young still arouses a particular concern that transcends politics, evoking talk of a lost generation. For one thing there are worries that crime may increase as a consequence. There is also concern that prolonged unemployment early in people's working lives will leave them scarred in the long term. Youngsters who have been jobless for a year or more tend to do worse in the labour market for the rest of their lives. They deserve a better start.

Private schools as charities

The axeman cometh

Jul 16th 2009
From The Economist print edition

The war against fee-paying schools takes on new life

St Anselm's

Class war in the classroom

EVEN among left-wingers, few talk about banning independent schools nowadays. There are craftier ways of overhauling the education system to fight privilege. One of them hit the headlines this week when the Charity Commission published its first "public-benefit" assessment, including five private schools among its chosen charitable specimens. Two—Highfield Priory in Lancashire and S. Anselm's in Derbyshire—failed the tough new requirement to show that they are helping the general public. The schools have a year to come up with a plan to get on track, or risk being taken over or closed down.

For centuries education has been considered a charitable activity, with no questions asked. In 2006 the rules were changed. Under the Charities Act of that year, schools are no longer entitled to the tax breaks that charitable status confers simply because they provide teaching. Instead, they have to demonstrate that they are actively benefiting the public. It has fallen to the regulator to interpret and apply the law: the commission says charities that charge fees, such as private schools, must ensure that "people in poverty" can use their services. The two schools that the commission flunked did not provide those who cannot afford the fees "sufficient opportunity to benefit".

All this takes place within a long tradition of class war in which private schools have been a main target. In an open letter to Dame Suzi Leather, the chairman of the commission, Sheila Lawlor, the director of think-tank Politeia and a former Conservative candidate for local office, complains of its "overt politicisation", claiming that the changes in the law did not require schools to be subject to such scrutiny. This may be a bit much. Sam Macdonald, a charity specialist at Farrer, a legal practice, says the principle of scrutinising fee-charging charities where there is a bar to access is fine, though he has "some sympathy with the idea that the rules have been applied subjectively and inconsistently".

The criteria are certainly confusing. The commission claims its assessments are based on everything that schools do, including partnerships with local communities and state schools, and that there is "no formula" for the number of bursaries that they must offer poor pupils. But the schools that failed the assessment were praised for their local initiatives and impugned for not offering more bursaries, whereas those that passed spent 5% or more of their income on financial aid. With few objective standards for charitable status spelled out, many schools suspect a stealthy Labour government of getting a quango to do its dirty work.

The commission's rulings have big financial implications for private schools already hit by recession. David Lyscom, head of the Independent Schools Council, says that more bursaries may have to be funded by increasing fees. "It would be deeply ironic," adds David Hanson, chief executive of the Independent Association of Preparatory Schools, "if schools were forced to raise fees to become more accessible".

Whatever its intrinsic merits, the timing of the crackdown is unfortunate. Private schools have been saving the public purse around £3 billion a year by educating 7% of all children. But as recession takes hold, parents are beginning to think twice. A fifth of local authorities already face increased pressure on school places, the Local Government Association reports, and steeper private-school fees will push more children into the state sector. The Charity Commission has revealed no formal plans to assess more private schools, but two-fifths of those it did scrutinise failed. Woe in the works for hard-pressed taxpayers.

Energy and climate change

Show us the money

Jul 16th 2009
From The Economist print edition

Good ideas are cheap, industrial policies expensive

Getty Images

Will Britain rule the waves again?

SO MUCH for Labour’s fearsome media machine. On the morning of July 15th Ed Miliband, the secretary of state for energy and climate change, was giving press interviews in London trumpeting his government’s plans to cut Britain’s greenhouse-gas emissions and rebuild its economy around clean energy. The very next day the Vestas wind-turbine plant on the Isle of Wight, the biggest in Britain, completed its final batch of turbine blades and shut up shop, with the loss of over 600 jobs.

It was an embarrassing reminder of the recurring gap between aspiration and achievement. Labour has made impressive noises about the need to tackle global warming and has signed Britain up to a smorgasbord of targets. Yet emissions of planet-heating gases have remained broadly stable over the past few years.

In an attempt to close that gap, the government decided in 2008 that it would treat carbon like money, setting up five-year, legally binding carbon budgets. The first requires a cut in national emissions of 22% from 1990 levels by 2012, and Mr Miliband detailed this week how that would happen. Power stations will bear most of the burden. Subsidies for renewables will be raised in the hope that wind, sun and waves will provide 30% of total electricity generation by 2020, and nuclear power another 8%. But although the government says it wants both atomic and renewable energy, not everyone believes it. Before the announcement there was a public war of words between the two industries, each keen to do the other down.

Mr Miliband had the guts to admit that building nuclear reactors and wind turbines would mean energy bills rising, an unpopular consequence that other politicians have avoided mentioning. Officials guess that Britain will have to spend £324 billion-404 billion ($532 billion-663 billion) by 2050 to scrub out carbon.

But so, runs the hope, will other countries, and the other half of the government’s plan is to prime British firms to take advantage of that. In the wake of the credit crunch there has been much talk of fiscal stimulus and the need to rebalance the economy away from financial services. Ministers have alighted on green industry as a winner of the future, with a global market now worth £3 trillion. Some usefully elastic definitions allow them to claim that there are already 800,000 “green jobs” in Britain (2.8% of the total) in an industry worth £106 billion.

Yet the money looks inadequate to the ambition. The biggest new dollop of cash is £405m for developing eco-industries, including £120m for offshore wind turbines, £60m for wave and tidal energy, and £15m for nuclear research. That pales next to the hundreds of billions the government mustered to bail out the finance industry it now hopes to trim. Gordon Edge, chief economist at the British Wind Energy Association, argues that raw financial firepower is less important than directing it wisely, but he concedes that Britain’s government has been less pushy than some. In fact, say analysts at HSBC, a bank, its Keynesian splurge is one of the world’s least green. Britain has allocated 7% of total spending to environmental causes, compared with 12% in America and 83% in South Korea.

How much any of this matters, however, is an open question. Many greens are more interested in the opposition Tories, who look a shoo-in at the election which must take place by next summer. In theory the

Conservatives have similar ideas to Labour about encouraging green business. But they are not traditionally a tree-hugging party, and many wonder how deep their new-found environmentalism runs.

Early in his leadership of the Tory Party David Cameron devoted much time to rebranding it as eco-friendly. He changed its logo to a tree, and built a little wind turbine atop his London home. The tree remains, but the turbine had been put up in the wrong place and had to be removed. Mr Cameron has subsequently moved house, and there is no sign of a replacement.

The spread of swine flu

Don't panic—yet

Jul 16th 2009
From The Economist print edition

Is Britain uniquely vulnerable to the global pandemic?

LOOK at Britain's press, and you would conclude that the place is about to be overwhelmed by swine flu. The number of confirmed cases, at more than 9,700, puts it among the world's hardest hit countries. The death toll seems to rise inexorably: 29 people have died carrying the virus, according to figures released on July 16th, and tragic tales of young girls and hapless physicians have been splashed across the headlines. The "exceptional" recent rise in reported infections led to the launch this week of a national phone and internet flu hot line. Even Cherie Blair, wife of the former prime minister, is thought to have caught the bug. One leading expert has said that swine flu might eventually afflict up to 40% of the British population.

Is there any scientific reason to think that Britain's people or health-care system makes it especially vulnerable to this global pandemic? The short answer is no. Britons are not genetically more vulnerable to the virus than other people. And their public-health system is, by international standards, very good.

Globalisation and centralisation, however, have quite a lot to answer for. Britain has strong ties through trade, investment and tourism with North America, where the pandemic probably originated. Many Britons were in hot spots there during the crucial weeks when swine flu was gathering pace unnoticed. According to official Mexican figures, British tourists typically outnumber those from any other EU country, even Spain. More people visit New York City, which has been especially affected by swine flu, from Britain than from any other country, including Canada. As the travellers returned home, they brought the bug with them. Add to the mix the fact that Heathrow is the busiest international crossroads in the world and the numbers are not hard to understand.

There is another factor too. Robert Dingwall of the University of Nottingham argues that the apparently large number of reported cases in Britain may stem in part from a very good system of surveillance. He contrasts Britain's centralised and relatively efficient public-health system with America's underfunded and chaotic set-up, in which states take the lead in counting cases and vary widely in the quality of information they manage to collect.

Yet if two-fifths of Britain's population does end up with swine flu, that seems a particularly heavy toll. Mr Dingwall says it is no more than other countries should expect, however: the standard models for predicting the course of pandemic diseases suggest that 30% to 40% of the world's population will suffer from the virus A/H1N1. And this strain of swine flu has not so far proven especially lethal. Despite the screaming headlines, he thinks, the number of deaths attributable to it in Britain is likely to resemble those from seasonal influenza "in an average winter, perhaps a bit worse".

Organised crime

Making a killing

Jul 16th 2009
From The Economist print edition

Professional gangsters have been living it up. Now the police want to make their lives harder

Illustration by David Simonds

"THERE must be 2,000 people working in this business, but only about 20 have been caught," said an Albanian people-trafficker, ruing his bad luck at ending up behind bars. The prisoner was describing a thriving industry that, in the words of the Home Office researchers who interviewed him and 44 other convicted traffickers, "conferred healthy profits with a low risk of detection". Britain's supposedly lax immigration checks and informal labour market make it an easy and appealing destination, the jailbirds reckoned. One large people-smuggling business is believed to process 700 migrants a year, turning a profit of £500,000.

People-trafficking is just part of an organised crime industry that appears to have blossomed in the past decade, according to an overhauled government strategy published on July 13th. Up to 30,000 people are employed in 4,000 organised crime groups in Britain, mainly in drugs, fraud (ID theft, phishing scams and the like) and illegal migration. These enterprises have bucked a downward trend in overall crime: though there has been a big drop in offences such as burglary and car theft, the activities associated with professional gangsters are booming. Police drug interdictions have soared, but cocaine is still consumed by twice as many people as it was a decade ago. Losses in fraud cases coming to court are their highest since 1995.

Each illegal sector has its own reasons for success: internet banks are easier to rob than high-street ones, for instance, and passport forgery has become easier since the accession to the EU of countries with more easily forgeable documents. And straitened economic circumstances now could present new business opportunities to gangsters of all types. Annual statistics published on July 16th gave a glimpse of how the recession may influence crime: burglary was stable but pickpocketing had risen by a quarter and credit-card fraud was up. (On the plus side, homicide unexpectedly plunged to a 20-year low.)

Organised crime may do especially well in the downturn because it depends so heavily on the bribery of officials, reckons Michael Levi, a professor of criminology at Cardiff University. A poor border guard is easier to tempt than a rich one, and a struggling business may be persuaded to launder money. On the other hand, some types of fraud may become less common: mortgages are more tightly regulated than before the financial crisis, Mr Levi notes. And Britain's appeal as a destination for migrants, legal or not, will depend on how its job market weathers the recession.

The fortunes of illegal enterprises over the past decade have been helped by the fact that they were low on the law-and-order agenda. Jon Murphy, head of organised-crime policy at the Association of Chief

Police Officers, accepts that his beat "has fallen somewhere between the demands of counter-terrorism and neighbourhood policing", the two areas that have preoccupied the government most of late. As terrorists and teenage yobs have been tackled, the organised criminals in the middle have prospered.

For this, the crime-busting targets that the police had until recently to meet were partly to blame. Solving high volumes of simple crimes such as burglary is easier than the long, expensive business of cracking a trafficking ring, and for a long time it received more credit from on high. (Other difficult crimes, including rape, are said to have been neglected for the same reason.) The target regime has now been replaced with a single measure of public confidence, which ought to eliminate some of the gaming that used to take place. But organised crime, often hidden from public view, may well continue to take a back seat to more obvious nuisances.

A second blind spot is caused by the localised structure of the police. England and Wales, a territory smaller than Florida, has 43 separate forces. The invention in 2006 of the Serious Organised Crime Agency, a sort of British FBI, was meant to help tackle crime that falls across several jurisdictions, but SOCA does much of its work at a national or indeed international level. Unexpectedly, the crisis in the public finances may improve co-operation by making forces pool their resources. An experimental unit in the East Midlands has drawn together officers from five forces to focus on organised crime to good effect, it seems.

The cash shortage is also behind plans to use "Al Capone" tactics, prosecuting Mr Bigs for tax evasion or driving offences when there are insufficient funds for the full surveillance operation needed to get a proper conviction. And the burden of proof in criminal asset-recovery cases may be reversed, forcing suspiciously wealthy people to prove that their possessions were acquired innocently.

Clearing up low-level crime, however, looks likely to remain the government's focus. Alan Johnson, the newish home secretary, used his first interview in the job to highlight anti-social behaviour; Chris Grayling, his Tory opposite number, quickly responded with a chilling promise to confiscate the bicycles of bad teenagers.

Most people think that organised crime is a problem in Britain, but many fewer say it looms large in their own area. Attitudes may be influenced by the fact that many people are themselves clients of organised crime: some 36% have tried illegal drugs; roughly one in 15 Londoners is an illegal immigrant. Some may also believe that if drugs, say, and prostitution were legal, trade in them would be less prone to violence and exploitation. Some sex-traffickers said they came to Britain to escape the "interference" in countries where their business is legal and regulated.

Care for the elderly

Nothing to write home about

Jul 16th 2009
From The Economist print edition

The government's new proposals raise more questions than they answer

Report Digital

Amazing grace

CARLTON HOUSE in Hatch End, north London, is a small, friendly place. A private care home, it has 22 elderly residents and a well-stocked garden where they sit of an afternoon. Several say that they like Carlton House, and can think of no way to improve it. But they are unhappy that they have had to sell their own homes to meet the bills of this one.

Even Andy Burnham, the health secretary, has described care for the elderly in Britain as "a cruel lottery". State aid for personal care (medical care is free on the National Health Service) is means-tested: those with £23,000 in assets must pay for their own. Some end up with bills of £200,000 whereas others receive care free. About 45,000 people are forced to sell their homes each year to pay for social care. Two-fifths of the roughly 450,000 now in residential-care homes pay their way.

As in other countries, a rapidly ageing population in Britain is pushing the care system towards crisis. Another 1.7m older people in England will require looking after by 2026, the government reckons. This will strain care budgets, which are already heading for a £6 billion annual gap in funding over the same period.

So the government's long-delayed consultation paper on July 14th was keenly awaited. Two radical options are ruled out: leaving people to pay for their own care and funding it entirely through general-tax revenues (devolved Scotland's version of the latter is already running out of cash). It outlines three approaches.

The first is a system of co-payments, in which the government would guarantee to everyone a payment equal to a quarter or a third of likely social-care costs, picking up more of the tab for poorer folk. The second is optional insurance, which would let people pay £20,000 to £25,000 to cover themselves against the rest of the cost of their care. The third is a compulsory state-insurance scheme, under which everyone who could afford it would be liable for a lump sum—paid on retirement, say, or from an estate after death—of £17,000 to £20,000 in exchange for the certainty of free care. No serious new government money is forthcoming under any of the options, and state funding would go only towards personal care: the cost of food and lodging in residential homes would fall to individuals who could pay for it.

Just how likely these reforms are remains to be seen. People who already save for their old age worry that they could be forced to cough up an additional £20,000 for care that they may never want. The proposals offer no guarantee that old folk will be able to hang on to their homes. And lump-sum premiums may prove a particularly hard sell: in a Populus poll for Saga, a firm specialising in services to the over-50s, only 6% preferred this option.

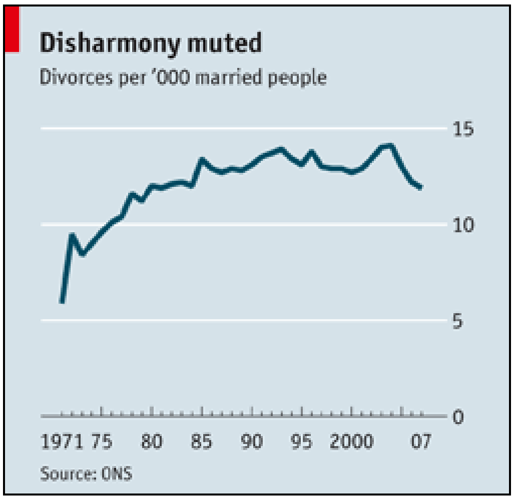
Yet some answer must be found to the escalating expense of looking after an increasingly old and frail population. The biggest difficulty with these proposals is that they come years after Labour first declared its interest in the matter, and far too late to be agreed before the next election. Over to the Tories, who have ideas of their own about sharing costs between individuals and the state.

Social trends

The decline of the English divorce

Jul 16th 2009
From The Economist print edition

Fewer marriages means stronger ones



BEFORE the economy fell apart, it was Britain's society that was supposed to be in terminal decline, especially in the eyes of the Tories. David Cameron, the Conservative Party leader, was wont to bemoan "broken Britain", mired in moral degeneracy, with high rates of teenage pregnancy, low rates of marriage and other less quantifiable breakdowns in the civilised scheme of things.

Such antediluvian worries were raked over again on July 13th when Iain Duncan Smith, a former Tory leader, called for an official endorsement of marriage. Mr Duncan Smith cites several reasons to encourage wedlock, including family stability (married couples are much less likely to split than cohabiting ones) and healthier children who do better in later life. There was talk of state-run counselling, pro-marriage propaganda in schools and mandatory "cooling-off" periods before divorces. Mr Duncan Smith favours tax breaks for married couples, something that Labour has long refused to endorse.

It is true that marriage is a declining institution. Marriage rates are at their lowest since 1895. But, curiously, those who do marry now stay together for longer. Divorce rates are falling, not rising, and have been for several years. In 2007 11.9 married couples per thousand untied the knot, down from 12.2 the year before and the lowest since 1981. The time that divorcing couples endure each other before flinging back the rings has lengthened too, from 10.1 years in 1981 to 11.7 in 2007. Indifference towards the sacrament of marriage appears strongest among the elderly, not the feckless young. Since 2004, when the overall divorce rate peaked at 14.1 per thousand, over-60s have been the only part of the population whose rates have continued to rise.

There are plenty of competing explanations for the diminishing appeal of divorce, and no easy way to discover which are true. Immigration may have helped, since immigrant families often have more conservative attitudes than the degenerate natives. Accountants and divorce lawyers reckon a string of recent big settlements may have acted as a deterrent (although it could equally have encouraged the poorer partners in financially unequal marriages).

Falling marriage rates and falling divorce rates could be two sides of the same coin, says Kathleen Kiernan, a professor of social policy at York University. The unpopularity of marriage and the relative ease of divorce has left only a hard core of stable couples bound in wedlock. And the rise in the average age at which people get married (now 36 for men and 33 for women) is helping too, since older brides and grooms tend to stay together longer in any case. If so, politicians should be cautious about handing out tax breaks. Even if they work (and Ms Kiernan thinks they would have to be enormous to have much effect), chivvying unmarried couples into wedlock is likely to mean more divorces in the future.

Bagehot

Tory splits!

Jul 16th 2009
From The Economist print edition

The cracks in the new Conservative Party—and the divisions to come

Illustration by Steve O'Brien

IN THE television programme "The Apprentice", competitors plead with the boss to be kept on the show, back-stabbing and self-promoting in a gladiatorial face-off with their peers. It is raw, compelling viewing. It is also an analogue of the way in which the Conservatives intend to resolve one of the most fractious problems of public policy. That is one of several reasons to wonder whether the splits that once crippled their party may reappear.

All of Britain's big parties are rumbling coalitions of interests, attitudes and ambitions. Insurgent parties, such as the Tories under David Cameron, need to disguise their tears and seams to win. So far, he has done an impressive job of therapy and discipline. But, if you look hard enough, the cracks are still there.

Unlike those in the Labour Party in the mid-1990s, when Tony Blair struggled to gag his less reconstructed colleagues, Tory splits are mostly not, for the time being, over policy. Some Tories are unmoved by the faddy theories that excite George Osborne, the shadow chancellor; some scoff at the cuddly rebranding Mr Cameron undertook; a few worry that he may prove more a damp-squib Heath than a revolutionary Thatcher. But the main clefts are chronological and clannish rather than ideological.

There is, in general, something different about the newer Tory MPs. Those elected in 2001, as Mr Cameron and Mr Osborne were, and 2005, as was Michael Gove, the shadow children's secretary, did not slog through the demoralising years of the 1990s. They are younger and less neurotic than the earlier vintages about their party's past. They also make up most of the elected element of the small cabal that now runs it (Oliver Letwin, the policy chief, and William Hague, the shadow foreign secretary, are the obvious exceptions).

Disgruntled Tory MPs describe a seigneurial party set-up, with Mr Cameron and Mr Osborne at the top, then a rank of appointed satraps: Ed Llewellyn, the leader's chief of staff; Steve Hilton, his main strategist; and Andy Coulson, his controversial media man. Some senior Tories complain about lack of access to the boss; they make dark comparisons with Mr Blair's corrosive elevation of spin doctors above his ministers. Some outside the shadow cabinet resent being passed over and neglected. That feeling was palpable even before the expenses scandal, over which some backbenchers say Mr Cameron showed indulgent favouritism to his acolytes, while sinking others in their moats.

Of course, party leaders often have cliques and courts (judging by Mr Cameron, Mr Blair and Gordon Brown, four or five is the preferred size of the inner circle). And splits can split both ways: sometimes they suggest a party that is broad and tolerant, rather than a tribe of line-toeing automatons. That was part of the rationale for bringing craggy Ken Clarke back to the front bench. For now, the prospect of a general-election victory has plaster-casted the most painful Tory fractures. The danger for Mr Cameron is that they reopen after he moves into Downing Street—aggravated by the means he uses to get there.

You're cut!

If the Tories win, they will send a startling number of new MPs to Westminster, especially given the large number of impending retirements by sitting ones, voluntary and otherwise. In theory this infusion represents Mr Cameron's chance to replace the parliamentary cadre he inherited with one moulded in his image. In practice, as a survey by Tim Montgomerie of Conservative Intelligence has shown, many of the novices may prove awkwardly independent. Most will not owe their places to Mr Cameron's list of preferred candidates. They will be even more devoutly Eurosceptic than the classes of 2001 and 2005. Meanwhile, the residue of old MPs will contain some whom Mr Cameron's centralised party-management has alienated. These elements will help to make up what may be a small Tory majority.

It may not be long before some of the ideological ruptures that seem to have healed burst. Europe is one risk: if the EU's Lisbon treaty is in force when Mr Cameron takes office, and he swallows it, the diehard rejectionists whom his ambiguity on the issue has kept in line may revolt. Meanwhile, depending on external events, the broader disagreement on foreign policy between the Tory realists and neocons—which Mr Cameron has tried to straddle, and which anyway seems somewhat moot in opposition—may become stark. Ditto the private doubts held by some senior Tories about their party's right-on stance on civil liberties. Then there is Mr Cameron's wrongheaded determination to promote marriage through the tax system—and, more explosively, the tax-cutting instinct that the party has temporarily suppressed, and which economic necessity may require Mr Cameron to thwart.

So to "The Apprentice". Part of the Tories' plan for fixing the finances involves a fiscal version of the show. Cabinet ministers who want more cash than the Treasury offers them would plead their case before their peers, stating whose budget the extra funds should come from. Mr Cameron and Mr Osborne would adjudicate, pronouncing "you're cut!" instead of "you're fired!". The aim is to instil collective responsibility for the inevitable squeeze. But the process may inspire rancour rather than harmony: no one wants to be history's most reviled defence secretary, or the education supremo known for shutting primary schools. A few will worry about the impact on their chances of succeeding Mr Cameron (for all the other trouble, Mr Brown's status as Mr Blair's heir created a sort of stability for Labour in this regard).

The underlying problem may be maintaining unity amid what could prove to be acute unpopularity. Mr Cameron should start now, by clarifying his European policy and his fiscal strategy while his position is strong. And he should pamper his MPs: he may think he doesn't need them now, but he might soon.

Economist.com/blogs/bagehot

The rights of Arctic peoples

Not a barren country

Jul 16th 2009 | NUUK, GREENLAND
From The Economist print edition

More political powers for the indigenous people of the Arctic could soon be matched by more economic clout

Arcticphoto

THE crowds in Nuuk, Greenland's pretty coastal capital, marked the devolution of more powers from Denmark, on midsummer's day, with cheers, processions and flags. The town thronged with men in white anoraks and women in *kalaallisuut*, an outfit of sealskin boots and trousers set off with a beaded top. Even a dusting of summer snow failed to chill the mood.

The newly elected prime minister of Greenland, Kuupik Kleist, who represents an Inuit-dominated party, promised that his country would act as an "equal partner" with Denmark, the old colonial power. The Danish prime minister, Lars Løkke Rasmussen, responded with a pledge that Greenland could claim full independence whenever it chooses. A more cordial separation is hard to imagine.

As in other parts of the Arctic, the indigenous people of Greenland are flexing their political muscles. In Greenland the Inuit, or part Inuit, account for nearly 90% of the total population of 57,000 or so, and they have been asserting ever-greater independence from Copenhagen, some 3,500km (2,175 miles) away. In similar fashion the Inuit of Canada won some powers of home rule over much of the country's Arctic Archipelago when the new territory of Nunavut was set up a decade ago. In northern Norway and Sweden (and to a lesser extent in Finland and Russia) the Sami people have claimed autonomous powers; 50,000-odd in Norway even have their own parliament. Within the Russian Federation two northern indigenous peoples, the Komi and Sakha (Yakuts) have, at least in theory, their "own" autonomous republics, though what powers that gives them in practice depends on the ebb and flow of politics elsewhere in Russia.

From New Zealand to Peru, the cause of indigenous people is one that stirs passion and widespread sympathy. A common struggle is either to curb mining or gain a share of the proceeds. In Canada a pressing demand is for consultation about their fate well before the prospectors arrive; in many places (Australia for example) the aboriginal peoples are struggling with social problems from alcoholism to domestic violence, brought by Europeans' arrival and the end of traditional nomadism.

But if the indigenous peoples have a good chance of asserting real economic and political power anywhere, then it is probably the Arctic. The polar peoples are still relatively numerous; few outsiders have been able to adapt to the beautiful but harsh physical environment. And most of the countries where they live happen to be democracies.

The sense of pride in Greenland is palpable. Greenlandic has become the official language. Embassies will soon be replacing consulates in Nuuk. "It's our land, our language, we have to do things ourselves," explains a local woman.

But translating nominal political power, for example over public funds for schools and hospitals, into real independence will take a long time yet. The economy of Greenland remains dependent on Danish largesse. Although Mr Kleist has confident plans to develop tourism, as well as hydropower plants to take advantage of meltwater running off the Greenlandic ice cap, the locals today rely on Danish dole worth some $11,000 per person per year.

A modern way of life in the far north is necessarily costly. Greenland runs a Nordic-style welfare state on a sparsely populated lump of ice three times the size of France. With few roads, almost any trip between settlements calls for the bright-red planes of Air Greenland. A large share of health spending is spent ferrying patients to clinics.

But handouts, argues a local businessman, themselves discourage the creation of a productive local economy. One of the reasons why Greenlanders need Danish subsidies is the social problems (including poor health and bad school results) that afflict so many indigenous groups in poorer places. Life-expectancy in Greenland is lower than it is in China, in part because of alcoholism and suicide.

Similar problems beset the 30,000 (mostly Inuit) people spread wide and far in Nunavut in Canada. The population has some things in its favour—it is young and growing fast. But many aboriginal northerners drop out of school early and end up relying on government funds or public-sector jobs. A few may survive, or at least supplement their incomes, through traditional hunting (these days more often with snowmobiles than with dogs) but the economic outlook is clouded. A parliamentary report from Canada, published in 2008, noted that aboriginal people in the country's north are typically poorer than their fellow citizens, as well as worse educated and more likely to be unemployed.

A pair of trump cards

Two factors, however, may boost Inuit bargaining power. One, oddly, is climate change. The receding ice cap in Greenland, and the melting of sea ice in the Arctic Ocean, are both threats and opportunities for his region, argues Mr Kleist. On the one hand warmer winters can make life harder for hunters, especially for those who rely on predictable sea ice. More rain and snow fall on Greenland in the winter. In some low-lying parts of the Arctic, the rising sea and storms are forcing whole villages to up sticks. Elsewhere melting permafrost is harming roads and runways. That raises costs for mining companies, seeking gold, rubies, diamonds, zinc, iron and more.

But warmer weather also stokes tourism: watching icebergs, for example, in Ilulissat, the third-largest town, where plans to extend the airport for long-haul flights are under way. The loss of pack ice also makes sea-transport in the Arctic easier for longer periods each year. And fishermen report a rise in some fish stocks.

Thinner sea ice is also making it easier to drill for oil and gas in the region, a second factor which could improve its prospects. Many local leaders worry that a large hydrocarbon industry in otherwise untouched parts of the Arctic threatens a vulnerable ecology—but they can hardly ignore a potential bonanza.

In the short term, many decisions about energy extraction in the polar regions will be made in courts and legislatures much farther south. For example, courts in the continental United States have been hearing disputes between oil firms and environmental groups about drilling in Alaskan waters.

A mixture of green challenges and the uncertain geopolitical outlook (Russia has identified the Arctic as a place where its aspirations may well conflict with those of neighbouring powers) mean that the world's oil and gas companies will have some hard calculations to make before they plunge into the melting waters of the pole. Almost all the sovereign powers in the region are making claims under the United Nations Law of the Sea, which allows countries to claim ownership of economic rights in parts of the seabed that are a physical extension of their own territory. Canada has until 2013 to file its claim—and intends to do so.

But as well as heeding the state interests of Canada, the United States and (for the time being) Denmark, would-be extractors will also have to take into account the determination of local people to claim a share of the action. The Inuit Circumpolar Council (ICC), which brings together Inuit representatives from around the Arctic, declared "sovereignty" over the Arctic's natural resources in April this year, in an effort to forestall what they described as "inappropriate" development.

In practice, however, oil and gas resources offer local people the most plausible route to economic independence. The United States Geological Survey estimates that the Arctic could hold 90 billion barrels of oil and 47 trillion cubic metres of gas, much of it off Greenland (other surveys are more modest). The new Greenlandic government is now enthusiastically granting licences to oil firms, such as ExxonMobil; companies are already prospecting over 137,000 square kilometres of the nearby seas. Exploratory drilling is expected to get under way soon.

At the same time, the Greenlandic authorities are making clear their determination to be respectable global citizens. An official of the island's Bureau of Minerals and Petroleum has specified that any companies extracting hydrocarbons in the neighbourhood must also develop and use carbon-storage technology. This would involve reinjecting carbon dioxide either deep underground or under the sea, in order to compensate the amount of heat-trapping gas that is being released into the atmosphere. In practice that may be a hard ideal to enforce. Artificial carbon storage on a large scale is still in its infancy; as environmentalists point out, some quite effective devices for carbon storage occur naturally—they are known as trees. But few of those are presently found in the Arctic.

In northern Norway the Sami, having won legal rights to some local resources under a 2005 law, are pushing for new compensation from firms exploiting minerals and oil and gas. “We want to have a part of the benefit of natural resources, minerals, gold, oil,” says Marianne Balto, vice-president of the Sami parliament.

Aqqaluk Lynge, an Inuit campaigner who leads the ICC’s Greenland branch, does not oppose development, but fears that the interests of local people are too easily neglected, even with the recent political changes. As one of the drafters of the declaration of Arctic sovereignty, he says his goal is to “make sure that the players in the Arctic area, while talking about the environment, climate change and development, realise we are already there. This is not a barren country.”

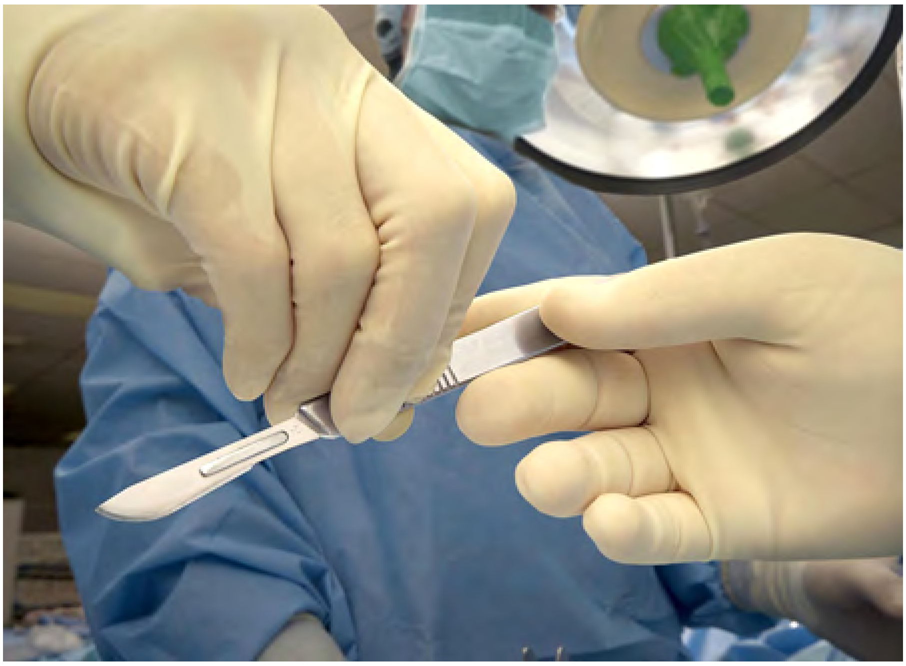
America's hospital industry

Taking a scalpel to costs

Jul 16th 2009 | NEW YORK
From The Economist print edition

Hospital operators brace themselves for health-care reform

Getty Images



EARLIER this month America's hospital bosses gathered in Washington, DC, with vice-president Joseph Biden. To the amazement of many, they vowed to accept a cut of $155 billion in their expected revenues over the next decade as part of a grand bargain on health-care reform. How can they justify giving away such a vast sum? There are several explanations, not all of them altruistic. Taken together, they show that the industry's leaders are bracing themselves for a period of upheaval.

For hospitals, the positive thing about health-care reform is that it is going to be good for business. It will be welcome news to an industry that is hardly in rude health. Despite two decades of consolidation, hospitals' finances remain anaemic; over a quarter of them regularly post negative operating margins. The recession is making things worse. Moody's, a credit-rating agency, notes that many patients are putting off non-essential treatments.

So any reforms that promise a flood of new demand for health services should be welcome. Rich Umbdenstock, the head of the American Hospital Association (AHA) and one of the bosses who shared the stage with Mr Biden, acknowledges that extending health insurance to most of America's nearly 50m uninsured will benefit his industry in the long term. Those unfortunates still turn up at emergency rooms and often do not pay their bills.

The government gives hospitals some money to compensate them for this, but the AHA says it does not cover the full cost, which it put at $34 billion in 2007 (around 5% of hospitals' annual revenues), up from $3.9 billion in 1980. Paul Mango of McKinsey, a consultancy, estimates that the hospitals recover only 10-12% of this cost. But he says the problem would be greatly reduced under a system of universal health-insurance which included subsidies for the indigent, as the proposed health reforms envisage. Herbert Pardes, chief executive of New York-Presbyterian, a research hospital, says the large numbers of underinsured patients, who frequently fail to pay their bills in full, cost hospitals still more.

The huge sums the hospitals stand to gain from reducing such losses make even $155 billion over ten years look like a reasonable amount of money to sacrifice to secure such a bonanza. But there are less

virtuous reasons why the hospitals offered such a generous-sounding deal. As Mr Umbdenstock notes, it was less painful than the $225 billion or more in cuts that Barack Obama had been pressing for earlier in the year. This is a tacit acknowledgment that hospital chiefs were seeking to avert the one thing that strikes fear into their hearts: the spread of price controls.

Because of the creeping expansion of Medicare and Medicaid, the publicly funded health-care schemes for the elderly and the poor, the government already pays over half the bills at the average American hospital. But the political left is clamouring for a government-run insurance plan, to compete with private ones, as part of any reform effort. The problem, argues Toby Cosgrove, chief executive of the Cleveland Clinic, a hospital group, is that the existing public schemes routinely underpay hospitals for care. Some economists question that claim. Even so, it is probably right to suggest, as Dr Cosgrove does, that any public insurance plan based on Medicare's pricing would squeeze hospitals hard and, as a result, require private insurers to cross-subsidise the bill.

In addition to a determination to head off any moves towards greater government control over prices, another even less noble reason for offering the price cut was a desire to thwart a proposed change to the tax status of non-profit hospitals, which make up most of the national total of 5,700 or so. On the ground that they provide charitable care, many religious and community hospitals have been granted an exemption allowing them to issue tax-free bonds, avoid taxes on property and income, and so on. But investigations by the Internal Revenue Service and others have revealed that many in fact provide very little charitable care, while paying enormous salaries or going on acquisition sprees.

On this proposal, the industry may carry the day. Although the tax break is hard to defend, closing the loophole would lead to many small, weak hospitals shutting down—something voters would be unlikely to tolerate. Even those hospitals that survived might spark a backlash. Dr Pardes argues that abolishing the tax advantages would mean higher running costs that would inevitably be passed through to those patients who have private insurance.

The other great fear of hospital bosses is being forced to accept greater competition. Although the industry is fragmented, Jon Scholl of the Boston Consulting Group points out that because pricing is done at city or regional level, there are "local pockets of power." Alain Enthoven, an economist at Stanford University's business school who helped inspire the "managed health care" movement of the 1990s, promoted an approach that succeeded in squeezing costs at the time, but ultimately failed as patients rebelled against the restrictions it placed on their choice of doctors and treatments. Mr Enthoven argues that the consolidation that followed managed care has resulted in too little competition. "Antitrust action in the hospital field has been woefully weak," he says.

There are some innovative competitors emerging to challenge hospitals. Paul Keckley of Deloitte, a consultancy, estimates that there are over 1,000 retail health clinics operating today at Wal-Mart stores, Walgreens pharmacies and other convenient locations, and their numbers are expected to multiply in the next few years. Some of these cheap and cheerful outfits are staffed by nurse practitioners (who are much cheaper than doctors), which incenses doctors and hospital bosses.

The nascent boom in medical tourism could also disrupt the hospital business, even if every hip-replacement patient does not actually go to India to get it done. Mr Keckley points out that in several parts of the country the mere introduction of insurance plans offering cheap surgery abroad has forced local hospitals to respond by slashing their prices—something unheard of in this industry.

Mr Enthoven argues that if reforms are done properly, they would "force hospitals to get organised to compete and get more efficient." Alas, the omens are not good. One of the explicit concessions wrung by the hospital bosses from the White House was a promise to crack down on clinics owned by doctors. These outfits are guilty of anti-competitive self-dealing, since the doctor has a financial motive to refer cases to his own firm, but what hospital bosses were really concerned about was that such clinics are competing hard with them, and siphoning off the most profitable patients.

As this back-room deal illustrates, the strongest motives behind the hospitals' ostensibly generous price cut were self-serving ones: to reduce competition, not boost it, and to head off any increase in government influence over their prices. As health-care reform forges ahead, reformers are desperate to find cost savings and the hospital industry is a juicy target. So its bosses felt they had to cut a deal. As Julius Hobson of Bryan Cave, a veteran health lobbyist, puts it: "If you're not at the table, then you're on the menu."

Drugs companies and poor countries

All together now

Jul 16th 2009 | NEW YORK
From The Economist print edition

New initiatives to cure diseases of the poor world

HEALTH-CARE activists have long maintained that the system for granting patents on drugs denies the poor access to essential medicines and discourages pharmaceutical firms from collaborating to develop new ones for neglected diseases. Several initiatives announced this week, some focused on collaboration and others on openness, may help to remedy those problems.

On July 14th GlaxoSmithKline (GSK), a British drugs giant, announced that it would waive patent restrictions to allow generic drugs firms to copy its HIV drugs for sale in poor countries. Notably, this waiver includes Abacavir, an advanced therapy that is used when the initial treatment for this disease fails. GSK had earlier announced that it would share its research and patent portfolios for HIV drugs with Pfizer, an American rival, in the hope of accelerating drug development in this area.

Novartis also plans to relax its patent position to help the poor. The Swiss drugs firm this week announced a partnership with the Institute for OneWorld Health, a non-profit research outfit, to develop drugs for secretory diarrhoea, a leading killer of children in poor countries. The firm will give the institute access to its proprietary research into drugs against cystic fibrosis, an unrelated disease that may nevertheless share genetic characteristics with diarrhoea. The institute has already screened the drugs in development by Roche, another Swiss firm, under a different deal that also involved waiving patent restrictions.

Another potential advance came this week as Cambia, a non-profit group in Australia, and that country's Queensland University of Technology unveiled the Global Initiative for Open Innovation. This new scheme, backed with money from the Gates Foundation, will combine open-access software and sophisticated search features to make the confusing thicket of drugs patents accessible to researchers the world over. So if collaboration does not do the trick, perhaps greater openness will.

Economist.com BUSINESS

The steel fist of government

Jul 16th 2009 | HONG KONG
From The Economist print edition

China's detention of Rio executives seems to be part of a worrying trend

Illustration by David Simonds

SYMBOLICALLY and practically, steel plays a large role in China's rapidly industrialising economy, and the main steelmakers have direct ties to the government. So no one in the country was in any doubt that the spreading investigation into the steelmakers' negotiations with foreign iron-ore miners, beginning with the detention on July 5th of four executives of Rio Tinto, an Anglo-Australian firm, represented a drastic government intervention in the workings of business. Just how drastic, however, continues to surprise.

On July 15th an executive at Laiwu Iron & Steel was reported to have been detained, the second non-Rio employee to be brought in after the earlier detention of a manager from the Shougang Group. These are large companies, important in their own right, but the news of the two executives' fate was quickly topped by a report in the government-controlled *China Daily*, quoting an anonymous "industry insider" as saying that managers at all 16 of the country's big steel companies involved in the iron-ore negotiations had been bribed by Rio.

In the face of these reports the government itself has been almost silent, noting only that the Rio case is tied to "state secrets" and "espionage". It has not explained why apparently routine business dealings are being treated as a matter of national security.

Rio, along with the other global iron-ore producers, has been in brutal price negotiations with China for many months, busting the deadlines for their completion. The detentions have done nothing to advance the negotiations, although some steelmakers are widely reported to have cracked and provisionally agreed to a cut in ore prices of only 33%. This is significantly less than they had sought, though it corresponds to prices that South Korean and Japanese mills had already agreed to.

The possible breakthrough followed reports that the ore producers had begun holding back deliveries to China. The delays in striking a deal had also caused a spike in ore prices on the spot market, benefiting Australian miners at the expense of the Chinese steelmakers.

The Chinese negotiators are known to have been deeply unhappy with the miners' proposed contract terms. But the use of spying charges in connection with what should be a purely commercial transaction has, given the opacity of the country's legal system, sent a shudder through foreign businesses operating in China. Australia's prime minister, Kevin Rudd, warned China's authorities that the move could injure their commercial relationships around the world. Besides making foreign firms think twice about investing, it could impede efforts by China's acquisitive resources companies to buy operations in other countries, by adding to foreigners' doubts about putting their industry in the hands of an opaque, quixotic government.

The Rio case comes on top of other, less publicised moves which involved bewildering use of the legal system and may also have been motivated by economic nationalism. In June three managers at Guangdong Development Bank in southern China were detained over unspecified matters. The bank is managed by Citigroup, which owns 20% of it. None of the employees was originally from Citi but one was the representative of China Life, also a large shareholder in the bank, and one of China's biggest companies.

The detentions were disclosed in mid-June, not long after the arrest of the mayor of Shenzhen, a fast-growing southern city, over allegations of corruption. More quietly, lawyers say there have been increasing threats of legal action or detentions tied to a number of property developments involving foreign firms there and in Tianjin, where another corruption investigation has been unfolding.

News of detentions often emerges, if at all, not from the authorities but from informal sources including the news media or family members. This only adds to suspicions about the true motives behind the investigations. One lawyer says his foreign clients are not waiting around for more information: they have begun asking to have their names removed from the boards of domestic Chinese operations, just in case they are next.

Kirin and Suntory discuss a merger

Kanpai!

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A proposed merger between two drinks firms may set a powerful example for corporate Japan

EPA

THERE is reason to clink glasses this week in Marunouchi, Tokyo's business district. On July 14th Kirin and Suntory, two big Japanese brewers, announced that they are in merger talks. A marriage would reshape the global drinks market by creating a company with sales of ¥3.8 trillion ($41 billion), providing strong competition to Anheuser-Busch InBev and SABMiller, two powerhouses formed in recent years.

But the deal also has big implications for corporate Japan. The country's business culture assumes that any company that agrees a merger or takeover is admitting failure. Most deals involve firms in distress. The Kirin-Suntory talks are notable because both firms are winners. And they underscore a new appreciation that success in Japan is no longer enough. Firms need to compete on a global scale, and thus need to be bigger.

So if the deal goes through and the firms integrate smoothly thereafter, it will set a powerful example. Although foreigners associate Japanese business with giant multinationals like Sony and Toyota, many of the country's industries have an excessive number of small, inwardly focused firms—electronic components, car parts and industrial goods, among others—precisely because of the hostility towards mergers and acquisitions (M&A). The result is meagre profits, starving even the best firms in each industry of capital as well as stopping them achieving the scale to compete on the world market.

Many of these midsized firms were created after the second world war and are still run by their founders. So they now face uncertainties over their bosses' succession. Banks and private-equity firms are clamouring to sell them M&A advice. But the old-timers are reluctant to let go. Such attitudes are unsustainable. The domestic market is shrinking as the population ages and declines. Firms will have to go abroad for growth and will need domestic scale to be able to contemplate this.

Still, a merger would be difficult. Kirin's culture as a public company tied to Mitsubishi, a big conglomerate, clashes with that of Suntory, a private, family firm. And achieving cost savings would mean closing factories and shedding staff—which Japanese bosses hate doing. But if they can pull it off, it may inspire firms in other businesses to consolidate.

The merged company would enjoy a domestic market-share of 30% for soft drinks, 50% for beer and nearly 80% for whisky. This would put the Japan Fair Trade Commission in an awkward spot. It has historically focused on domestic market power when reviewing mergers, but it is now under pressure from the trade ministry to allow dominant firms to form, to foster the creation of global champions. In short, if the Kirin-Suntory merger goes through it could be the start of a big change in the way Japan does business.

Online gambling in Europe

A stacked deck

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Recalcitrant European governments refuse to open their gambling markets

PROFESSIONAL poker players say that if you have been playing for a while and cannot figure out who the patsy is, it's you. This dictum also applies to those involved in a high-stakes game between the European Commission, online-gambling firms and several European countries opposed to internet betting. The European Union's supposed single market, which the commission polices, is fractured over the issue. A study for the European Parliament last year found that seven of the union's 27 members outlaw online gambling. Of the other 20, only 13 have liberalised their markets. The rest limit online gambling to monopolies owned or licensed by the state.

The sharpest crackdown on gambling firms in Europe is now taking place in the Netherlands, which only allows its residents to place online bets with a state monopoly, De Lotto. Earlier this year the government ratcheted up the pressure on foreign betting firms. Its tactics seem to have been copied from America, which in 2006 struck at online-gambling firms by threatening the banks that they used. In February the Dutch Ministry of Justice warned banks in the country that they could be prosecuted for transferring money from the accounts of Dutch residents to those of online-gambling firms abroad.

Other countries are also pursuing prohibition of various sorts. In Germany, where a ban on online gambling came into force last year, the state of North Rhine-Westphalia has ordered Betfair, a British firm (see article), to block access to its residents. A Dusseldorf court is expected shortly to rule on the legality of that order. In February a Greek court told Stanleybet, a British firm, to shut its operations in Greece. Germany, Estonia, Sweden and Hungary have either passed or are contemplating laws to force internet providers to block access to gambling websites, says Gambling Compliance, a consultancy.

Most European countries that ban or restrict online gambling argue that they do so to protect consumers from themselves. That argument wears thin, however, in countries such as Sweden or the Netherlands that still allow gambling through national monopolies. The rate of "problem gambling" in these countries is similar to that in Britain, which has liberalised.

The real problem is that online betting threatens the revenue governments earn from local monopolies. In the Netherlands, for instance, gambling winnings are taxed at 29%. Gibraltar, where most British online gambling firms pay tax, takes just 1% of the pot. "The policy of many of the EU member states towards online gambling seems to be motivated more by protection of the public purse than by protection of the public," says Leighton Vaughan Williams of the Betting Research Unit at Nottingham Business School.

There is a lot of money at stake. The gross profit from online betting in Europe is thought to be about €3.5 billion ($5 billion) a year. Just as important are questions of principle over member countries' authority to override the single market on sensitive issues like gambling. In this respect the commission has played a strong hand badly. It feels that countries cannot close their markets to gambling firms from elsewhere in Europe and has a number of court rulings to back that view. But it has little stomach for a fight over a subject that touches such a raw nerve. It has scolded France, Sweden, Greece, Denmark, Hungary and the Netherlands by issuing "reasoned opinions" arguing that they are in breach of European law. It has threatened to take them to the European Court of Justice. Yet the recalcitrant countries continue to behave as if the commission is the patsy.

Spain tries to encourage start-ups

Nurturing the youngsters

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Spain's infant firms need more than a junior stockmarket to help them grow

ITV

Growing fast

BESIDES entertaining millions of tiny tots around the world, Pocoyó, an animated cartoon character, this week briefly caught the attention of Spanish investors. Zinkia, the company that produces the programme, became the first firm to list on Spain's new small-cap exchange, the Mercado Alternativo Bursátil (MAB), created to nurture corporate infants and help more of them reach maturity.

It may seem an odd time to be going public. The market in Europe has been shut for months. But Spain's smaller firms are desperate for cash. They complain that the banks, which are heavily exposed to the burst property bubble, have become extremely reluctant to lend to them.

Bankers say there is a long line of small companies waiting to list on the MAB—the exchange itself reckons Spain has around 5,000 eligible firms. There are good business ideas out there, but hardly anyone is willing to bankroll them right now, says Pedro Nueno of IESE, a business school. Venture capital is virtually non-existent in Spain. The MAB might bring forth more risk capital by providing investors with a possible exit.

Zinkia shares were peddled mostly to "family offices", the investment vehicles of wealthy families. Fed up with opaque financial products from banks, they are increasingly keen to invest in growing companies, says Enrique Quemada of ONEtoONE Capital Partners, an investment bank. But these investors are still cautious, not least because of small-cap shares' lack of liquidity. In any case, Zinkia was too greedy with regard to its valuation. It ended up having to price its shares at 27.5% below the bottom of the indicative price it set for its initial public offering, valuing the company at €40m ($56m), and it had to drop plans for a sale of shares by existing shareholders.

Even if the MAB takes off, financing is not the only thing holding back entrepreneurs. The Spanish are rather risk-averse. "If Bill Gates had lived in Spain, Microsoft would have never existed," says Xavier Sala-i-Martin, an economist at Columbia University in New York. Many also blame a local culture of "*el pelotazo*"—seeking a fast buck rather than patiently building a business. Spain's government is keen to encourage more innovative small companies by offering credit lines. Yet these are too focused on what Mr Nueno calls the "marginal entrepreneur", or one-person outfits. To foster firms with more chance of becoming a Spanish Microsoft, incentives for venture capital and for investing on the MAB might help.

Increasing state spending on research and development is important, but just throwing money at scientists will not work. There need to be stronger links between businesses and universities. Companies also complain that the country's education system places too much emphasis on rote learning rather than critical thinking. And the government could cut red tape. It takes 47 days to open a new business in Spain, compared with six days in America, according to the World Bank's "Doing Business" survey. As many other countries have found, in nurturing infant companies, as with bringing up children, there are no easy answers.

Face value

Turning up the gas

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Faisal Al Suwaidi has become a victim of his own success in creating a worldwide market for liquid natural gas

Qatargas

RED flames shimmer behind a thick shroud of smoke at the Ras Laffan gas plant in Qatar. Methane from the bottom of the Persian Gulf is part-combusted and filtered in a spaghetti-like tangle of steel pipes. Further along, the gas is cooled in bulbous storage tanks to minus 160°C, turning it into liquid and reducing it to one-six-hundredth of its original volume, ready to be sent across the oceans aboard a new generation of supercarriers. Local officials boast that the plant will be the largest structure made by man in centuries when it is finished next year. Already it produces a quarter of the world's liquefied natural gas (LNG).

Ras Laffan is a singular industrial success, but that was no foregone conclusion. It would not have been built without one man taking a gamble. Faisal Al Suwaidi, the boss of Qatargas, wagered a decade ago that a massive boost in production would create a market large enough for his country's main asset, the world's biggest known gasfield. When it was discovered in 1971, Qataris were dismayed. Mr Suwaidi, who got his first job in the petroleum industry the following year, remembers there being a lingering disappointment that gas, not oil, had been found in the vast offshore North Field. Nobody traded gas then. Later a regional market developed in eastern Asia, with Japan and South Korea buying LNG from gas-rich Indonesia, Malaysia and Brunei, but gas remained oil's underachieving younger sibling, lacking a global market.

Then in the late 1990s Mr Suwaidi set out to create such a market by taking three important steps. First, to build Ras Laffan and its extraction facilities, he pledged full co-operation with foreign partners. This may sound obvious. But the industry's sorry state at the time had much to do with producer countries, including Russia, Iran and Saudi Arabia, refusing to pay for superior foreign expertise, or accept the political costs of doing so. Not so the Qataris. Companies such as Shell, Total and Exxon Mobil became full partners, says Mr Suwaidi, and made all the difference.

Second, he focused on selling gas to faraway nations rather than Gulf neighbours. Only they would have enough demand for LNG in the long run. To do this he had to reduce prices and offer more flexible contracts. Japan became an early client and the first industrial nation to rely on long-distance gas deliveries. China and India followed as their economies began to boom. Europe, too, developed an appetite. In May this year Qatargas opened the largest European LNG import terminal at South Hook on the Welsh coast, supplying a fifth of Britain's gas needs. South Hook is part-owned by the Qataris, hinting at Mr Suwaidi's third innovation. National energy firms rarely pay for the vast infrastructure

needed to liquefy gas, ship it in freeze tanks and regasify it close to consumers. Mr Suwaidi, by contrast, invested heavily in such facilities. Ras Laffan alone may have cost of the order of $60 billion (there are no official figures). He also commissioned a fleet of gas ships, twice the size of the biggest existing ones.

His gamble paid off handsomely. Together with another Qatari firm, RasGas, Qatargas now dominates the world LNG market. The resulting flood of wealth has brought huge change at home. Qatar had no schools or hospitals when Mr Suwaidi was born in 1954. Since then its population has grown forty-fold. Its national income per head is now among the world's highest. This year its economy may grow by 10%, and new capacity coming on-stream during 2009 will double Qatar's LNG production capacity to 62m tonnes a year. By 2011 it expects to produce 77m tonnes a year, providing half as much energy as Saudi Arabia's oil output.

But once that target has been hit, production will be capped, with no plans for further expansion. The era of bold innovation is drawing to a close. Speaking at a recent industry conference, Mr Suwaidi sounded nothing like a visionary. He rattled on about safety at his plants: an important subject, but hardly what one would expect to be his main preoccupation. "People give me a lot of credit but I just listen to what others say," he says, tying a string of worry-beads around his thumb. How then did he get this far? He says he was just "lucky", like one of Napoleon's generals.

From seller's market to buyer's

Mr Suwaidi's unexpected modesty comes after a gruelling few years. He appears to have been cowed by continual construction delays at Ras Laffan. Sam Ciszuk, an analyst at IHS Global Insight, says the plant's completion has become "more like a test of endurance than a crowning moment". On top of that, gas prices have collapsed over the past year. Spot prices fell by 75%, more even than oil. The gas equivalent of a barrel of crude now sells for around $20. The industry is seeing its first glut, not least because so much extra capacity has been built. Mr Suwaidi is a victim of his own success. He turned a seller's market into a buyer's market. Fortunately most LNG is bought on longish fixed-price contracts, otherwise things would be much more serious for him.

Mr Suwaidi's new-found conservatism mirrors a wider change in Qatar. His political masters, the ruling Thani family, have suspended exploration of the North Field, hoping to sustain output for 100 years. And they have backed plans by Russia and Iran to create a gas cartel analogous to OPEC. A secretariat is being set up in Doha. Qatar is becoming a new Saudi Arabia, more concerned with market stability than maximising short-term profits.

Even so, long-term demand for gas has never looked better. China and India look set to continue growing fast, as will their energy needs. Besides being cheaper than oil, gas emits less carbon dioxide when burned, so its attraction has grown along with rising concern about climate change. Some producers, like Canada, Norway and Britain, are running out of reserves. Meanwhile Russia's aggressive energy policies have made its European customers wary. Qatar, by contrast, underlined its dependability by inviting America's armed forces to build a large base there. Despite the current price slump, Mr Suwaidi's faith in a global LNG market seems likely to be rewarded.

The state of economics

The other-worldly philosophers

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From The Economist print edition

Although the crisis has exposed bitter divisions among economists, it could still be good for economics. Our first article looks at the turmoil among macroeconomists. Our second (see article) examines the foundations of financial economics

Illustration by Brett Ryder

ROBERT LUCAS, one of the greatest macroeconomists of his generation, and his followers are "making ancient and basic analytical errors all over the place". Harvard's Robert Barro, another towering figure in the discipline, is "making truly boneheaded arguments". The past 30 years of macroeconomics training at American and British universities were a "costly waste of time".

To the uninitiated, economics has always been a dismal science. But all these attacks come from within the guild: from Brad DeLong of the University of California, Berkeley; Paul Krugman of Princeton and the *New York Times*; and Willem Buiter of the London School of Economics (LSE), respectively. The macroeconomic crisis of the past two years is also provoking a crisis of confidence in macroeconomics. In the last of his Lionel Robbins lectures at the LSE on June 10th, Mr Krugman feared that most macroeconomics of the past 30 years was "spectacularly useless at best, and positively harmful at worst".

These internal critics argue that economists missed the origins of the crisis; failed to appreciate its worst symptoms; and cannot now agree about the cure. In other words, economists misread the economy on the way up, misread it on the way down and now mistake the right way out.

On the way up, macroeconomists were not wholly complacent. Many of them thought the housing bubble would pop or the dollar would fall. But they did not expect the financial system to break. Even after the seizure in interbank markets in August 2007, macroeconomists misread the danger. Most were quite sanguine about the prospect of Lehman Brothers going bust in September 2008.

Nor can economists now agree on the best way to resolve the crisis. They mostly overestimated the power of routine monetary policy (ie, central-bank purchases of government bills) to restore prosperity. Some now dismiss the power of fiscal policy (ie, government sales of its securities) to do the same. Others advocate it with passionate intensity.

Among the passionate are Mr DeLong and Mr Krugman. They turn for inspiration to Depression-era texts, especially the writings of John Maynard Keynes, and forgotten mavericks, such as Hyman Minsky. In the humanities this would count as routine scholarship. But to many high-tech economists it is a bit undignified. Real scientists, after all, do not leaf through Newton's "Principia Mathematica" to solve

contemporary problems in physics.

They accuse economists like Mr DeLong and Mr Krugman of falling back on antiquated Keynesian doctrines—as if nothing had been learned in the past 70 years. Messrs DeLong and Krugman, in turn, accuse economists like Mr Lucas of not falling back on Keynesian economics—as if everything had been forgotten over the past 70 years. For Mr Krugman, we are living through a "Dark Age of macroeconomics", in which the wisdom of the ancients has been lost.

What was this wisdom, and how was it forgotten? The history of macroeconomics begins in intellectual struggle. Keynes wrote the "General Theory of Employment, Interest and Money", which was published in 1936, in an "unnecessarily controversial tone", according to some readers. But it was a controversy the author had waged in his own mind. He saw the book as a "struggle of escape from habitual modes of thought" he had inherited from his classical predecessors.

That classical mode of thought held that full employment would prevail, because supply created its own demand. In a classical economy, whatever people earn is either spent or saved; and whatever is saved is invested in capital projects. Nothing is hoarded, nothing lies idle.

Keynes appreciated the classical model's elegance and consistency, virtues economists still crave. But that did not stop him demolishing it. In his scheme, investment was governed by the animal spirits of entrepreneurs, facing an imponderable future. The same uncertainty gave savers a reason to hoard their wealth in liquid assets, like money, rather than committing it to new capital projects. This liquidity-preference, as Keynes called it, governed the price of financial securities and hence the rate of interest. If animal spirits flagged or liquidity-preference surged, the pace of investment would falter, with no obvious market force to restore it. Demand would fall short of supply, leaving willing workers on the shelf. It fell to governments to revive demand, by cutting interest rates if possible or by public works if necessary.

The Keynesian task of "demand management" outlived the Depression, becoming a routine duty of governments. They were aided by economic advisers, who built working models of the economy, quantifying the key relationships. For almost three decades after the second world war these advisers seemed to know what they were doing, guided by an apparent trade-off between inflation and unemployment. But their credibility did not survive the oil-price shocks of the 1970s. These condemned Western economies to "stagflation", a baffling combination of unemployment and inflation, which the Keynesian consensus grasped poorly and failed to prevent.

The Federal Reserve, led by Paul Volcker, eventually defeated American inflation in the early 1980s, albeit at a grievous cost to employment. But victory did not restore the intellectual peace. Macroeconomists split into two camps, drawing opposite lessons from the episode.

The purists, known as "freshwater" economists because of the lakeside universities where they happened to congregate, blamed stagflation on restless central bankers trying to do too much. They started from the classical assumption that markets cleared, leaving no unsold goods or unemployed workers. Efforts by policymakers to smooth the economy's natural ups and downs did more harm than good.

Illustration by Brett Ryder

America’s coastal universities housed most of the other lot, “saltwater” pragmatists. To them, the double-digit unemployment that accompanied Mr Volcker’s assault on inflation was proof enough that markets could malfunction. Wages might fail to adjust, and prices might stick. This grit in the economic machine justified some meddling by policymakers.

Mr Volcker’s recession bottomed out in 1982. Nothing like it was seen again until last year. In the intervening quarter-century of tranquillity, macroeconomics also recovered its composure. The opposing schools of thought converged. The freshwater economists accepted a saltier view of policymaking. Their opponents adopted a more freshwater style of modelmaking. You might call the new synthesis brackish macroeconomics.

Pinches of salt

Brackish macroeconomics flowed from universities into central banks. It underlay the doctrine of inflation-targeting embraced in New Zealand, Canada, Britain, Sweden and several emerging markets, such as Turkey. Ben Bernanke, chairman of the Fed since 2006, is a renowned contributor to brackish economics.

For about a decade before the crisis, macroeconomists once again appeared to know what they were doing. Their thinking was embodied in a new genre of working models of the economy, called “dynamic stochastic general equilibrium” (DSGE) models. These helped guide deliberations at several central banks.

Mr Buiter, who helped set interest rates at the Bank of England from 1997 to 2000, believes the latest academic theories had a profound influence there. He now thinks this influence was baleful. On his blog, Mr Buiter argues that a training in modern macroeconomics was a “severe handicap” at the onset of the financial crisis, when the central bank had to “switch gears” from preserving price stability to safeguarding financial stability.

Modern macroeconomists worried about the prices of goods and services, but neglected the prices of assets. This was partly because they had too much faith in financial markets. If asset prices reflect economic fundamentals, why not just model the fundamentals, ignoring the shadow they cast on Wall Street?

It was also because they had too little interest in the inner workings of the financial system. “Philosophically speaking,” writes Perry Mehrling of Barnard College, Columbia University, economists are “materialists” for whom “bags of wheat are more important than stacks of bonds.” Finance is a veil, obscuring what really matters. As a poet once said, “promises of payment/Are neither food nor raiment”.

In many macroeconomic models, therefore, insolvencies cannot occur. Financial intermediaries, like

banks, often don't exist. And whether firms finance themselves with equity or debt is a matter of indifference. The Bank of England's DSGE model, for example, does not even try to incorporate financial middlemen, such as banks. "The model is not, therefore, directly useful for issues where financial intermediation is of first-order importance," its designers admit. The present crisis is, unfortunately, one of those issues.

The bank's modellers go on to say that they prefer to study finance with specialised models designed for that purpose. One of the most prominent was, in fact, pioneered by Mr Bernanke, with Mark Gertler of New York University. Unfortunately, models that include such financial-market complications "can be very difficult to handle," according to Markus Brunnermeier of Princeton, who has handled more of these difficulties than most. Convenience, not conviction, often dictates the choices economists make.

Convenience, however, is addictive. Economists can become seduced by their models, fooling themselves that what the model leaves out does not matter. It is, for example, often convenient to assume that markets are "complete"—that a price exists today, for every good, at every date, in every contingency. In this world, you can always borrow as much as you want at the going rate, and you can always sell as much as you want at the going rate.

Before the crisis, many banks and shadow banks made similar assumptions. They believed they could always roll over their short-term debts or sell their mortgage-backed securities, if the need arose. The financial crisis made a mockery of both assumptions. Funds dried up, and markets thinned out. In his anatomy of the crisis Mr Brunnermeier shows how both of these constraints fed on each other, producing a "liquidity spiral".

What followed was a furious dash for cash, as investment banks sold whatever they could, commercial banks hoarded reserves and firms drew on lines of credit. Keynes would have interpreted this as an extreme outbreak of liquidity-preference, says Paul Davidson, whose biography of the master has just been republished with a new afterword. But contemporary economics had all but forgotten the term.

Fiscal fisticuffs

The mainstream macroeconomics embodied in DSGE models was a poor guide to the origins of the financial crisis, and left its followers unprepared for the symptoms. Does it offer any insight into the best means of recovery?

In the first months of the crisis, macroeconomists reposed great faith in the powers of the Fed and other central banks. In the summer of 2007, a few weeks after the August liquidity crisis began, Frederic Mishkin, a distinguished academic economist and then a governor of the Fed, gave a reassuring talk at the Federal Reserve Bank of Kansas City's annual symposium in Jackson Hole, Wyoming. He presented the results of simulations from the Fed's FRB/US model. Even if house prices fell by a fifth in the next two years, the slump would knock only 0.25% off GDP, according to his benchmark model, and add only a tenth of a percentage point to the unemployment rate. The reason was that the Fed would respond "aggressively", by which he meant a cut in the federal funds rate of just one percentage point. He concluded that the central bank had the tools to contain the damage at a "manageable level".

Since his presentation, the Fed has cut its key rate by five percentage points to a mere 0-0.25%. Its conventional weapons have proved insufficient to the task. This has shaken economists' faith in monetary policy. Unfortunately, they are also horribly divided about what comes next.

Mr Krugman and others advocate a bold fiscal expansion, borrowing their logic from Keynes and his contemporary, Richard Kahn. Kahn pointed out that a dollar spent on public works might generate more than a dollar of output if the spending circulated repeatedly through the economy, stimulating resources that might otherwise have lain idle.

Today's economists disagree over the size of this multiplier. Mr Barro thinks the estimates of Barack Obama's Council of Economic Advisors are absurdly large. Mr Lucas calls them "schlock economics", contrived to justify Mr Obama's projections for the budget deficit. But economists are not exactly drowning in research on this question. Mr Krugman calculates that of the 7,000 or so papers published by the National Bureau of Economic Research between 1985 and 2000, only five mentioned fiscal policy in their title or abstract.

Illustration by Brett Ryder

Do these public spats damage macroeconomics? Greg Mankiw, of Harvard, recalls the angry exchanges in the 1980s between Robert Solow and Mr Lucas—both eminent economists who could not take each other seriously. This vitriol, he writes, attracted attention, much like a bar-room fist-fight. But he thinks it also dismayed younger scholars, who gave these macroeconomic disputes a wide berth.

By this account, the period of intellectual peace that followed in the 1990s should have been a golden age for macroeconomics. But the brackish consensus also seems to leave students cold. According to David Colander, who has twice surveyed the opinions of economists in the best American PhD programmes, macroeconomics is often the least popular class. "What did you learn in macro?" Mr Colander asked a group of Chicago students. "Did you do the dynamic stochastic general equilibrium model?" "We learned a lot of junk like that," one replied.

It takes a model to beat a model

The benchmark macroeconomic model, though not junk, suffers from some obvious flaws, such as the assumption of complete markets or frictionless finance. Indeed, because these flaws are obvious, economists are well aware of them. Critics like Mr Buiter are not telling them anything new. Economists can and do depart from the benchmark. That, indeed, is how they get published. Thus a growing number of cutting-edge models incorporate one or two financial frictions. And economists like Mr Brunnermeier are trying to fit their small, "blackboard" models of the crisis into a larger macroeconomic frame.

But the benchmark still matters. It formalises economists' gut instincts about where the best analytical cuts lie. It is the starting point to which the theorist returns after every ingenious excursion. Few economists really believe all its assumptions, but few would rather start anywhere else.

Unfortunately, it is these primitive models, rather than their sophisticated descendants, that often exert the most influence over the world of policy and practice. This is partly because these first principles endure long enough to find their way from academia into policymaking circles. As Keynes pointed out, the economists who most influence practical men of action are the defunct ones whose scribblings have had time to percolate from the seminar room to wider conversations.

These basic models are also influential because of their simplicity. Faced with the "blooming, buzzing confusion" of the real world, policymakers often fall back on the highest-order principles and the broadest presumptions. More specific, nuanced theories are often less versatile. They shed light on whatever they were designed to explain, but little beyond.

Would economists be better off starting from somewhere else? Some think so. They draw inspiration from neglected prophets, like Minsky, who recognised that the "real" economy was inseparable from the financial. Such prophets were neglected not for what they said, but for the way they said it. Today's economists tend to be open-minded about content, but doctrinaire about form. They are more wedded to their techniques than to their theories. They will believe something when they can model it.

Mr Colander, therefore, thinks economics requires a revolution in technique. Instead of solving models

“by hand”, using economists’ powers of deduction, he proposes simulating economies on the computer. In this line of research, the economist specifies simple rules of thumb by which agents interact with each other, and then lets the computer go to work, grinding out repeated simulations to reveal what kind of unforeseen patterns might emerge. If he is right, then macroeconomists, like zombie banks, must write off many of their past intellectual investments before they can make progress again.

Mr Krugman, by contrast, thinks reform is more likely to come from within. Keynes, he observes, was a “consummate insider”, who understood the theory he was demolishing precisely because he was once convinced by it. In the meantime, he says, macroeconomists should turn to patient empirical spadework, documenting crises past and present, in the hope that a fresh theory might later make sense of it all.

Macroeconomics began with Keynes, but the word did not appear in the journals until 1945, in an article by Jacob Marschak. He reviewed the profession’s growing understanding of the business cycle, making an analogy with other sciences. Seismology, for example, makes progress through better instruments, improved theories or more frequent earthquakes. In the case of economics, Marschak concluded, “the earthquakes did most of the job.”

Economists were deprived of earthquakes for a quarter of a century. The Great Moderation, as this period was called, was not conducive to great macroeconomics. Thanks to the seismic events of the past two years, the prestige of macroeconomists is low, but the potential of their subject is much greater. The furious rows that divide them are a blow to their credibility, but may prove to be a spur to creativity.

Economist.com OPINION

Financial economics

Efficiency and beyond

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The efficient-markets hypothesis has underpinned many of the financial industry's models for years. After the crash, what remains of it?

Illustration by Brett Ryder

IN 1978 Michael Jensen, an American economist, boldly declared that "there is no other proposition in economics which has more solid empirical evidence supporting it than the efficient-markets hypothesis" (EMH). That was quite a claim. The theory's origins went back to the beginning of the century, but it had come to prominence only a decade or so before. Eugene Fama, of the University of Chicago, defined its essence: that the price of a financial asset reflects all available information that is relevant to its value.

From that idea powerful conclusions were drawn, not least on Wall Street. If the EMH held, then markets would price financial assets broadly correctly. Deviations from equilibrium values could not last for long. If the price of a share, say, was too low, well-informed investors would buy it and make a killing. If it looked too dear, they could sell or short it and make money that way. It also followed that bubbles could not form—or, at any rate, could not last: some wise investor would spot them and pop them. And trying to beat the market was a fool's errand for almost everyone. If the information was out there, it was already in the price.

On such ideas, and on the complex mathematics that described them, was founded the Wall Street profession of financial engineering. The engineers designed derivatives and securitisations, from simple interest-rate options to ever more intricate credit-default swaps and collateralised debt obligations. All the while, confident in the theoretical underpinnings of their inventions, they reassured any doubters that all this activity was not just making bankers rich. It was making the financial system safer and the economy healthier.

That is why many people view the financial crisis that began in 2007 as a devastating blow to the credibility not only of banks but also of the entire academic discipline of financial economics. That verdict is too simple. Granted, financial economists helped to start the bankers' party, and some joined in with gusto. But even when the EMH still seemed fresh, economists were picking holes in it. A strand of sceptical thought, behavioural economics, has been booming. There are even signs of a synthesis between the EMH and the sceptics. Academia thus moved on, even if Wall Street did not. Nonetheless, the extent to which politicians and regulators trying to reform finance can trust financial economists is an open question.

The EMH, to be sure, has loyal defenders. "There are models, and there are those who use the models," says Myron Scholes, who in 1997 won the Nobel prize in economics for his part in creating the most widely used model in the finance industry—the Black-Scholes formula for pricing options. Mr Scholes thinks much of the blame for the recent woe should be pinned not on economists' theories and models but on those on Wall Street and in the City who pushed them too far in practice.

Financial firms plugged in data that reflected a "view of the world that was far more benign than it was reasonable to take, emphasising recent inputs over more historic numbers," says Mr Scholes. "Apparently, a lot of the models used for structured products were pretty good, but the inputs were awful." Indeed, the vast majority of derivative contracts and securitisations have performed exactly as their models said they would. It was the exceptions that proved disastrous.

Mr Scholes knows whereof he speaks. Long-Term Capital Management (LTCM), a hedge fund he founded with, among others, Robert Merton, a fellow Nobel laureate, skidded off the road in 1998. Since then, he has been pointing out dangers ignored or underestimated in the finance industry, such as the risk that

liquid markets can dry up far faster than is typically assumed. (That did not stop Platinum Grove, the latest hedge fund in which he is involved, taking a big hit during the recent meltdown.)

He has also been "criticising for years" the "value-at-risk" (VAR) models used by institutional investors to work out how much capital they need to set aside as insurance against losses on risky assets. These models mistakenly assume that the volatility of asset prices and the correlations between prices are constant, says Mr Scholes. When, say, two types of asset were assumed to be uncorrelated, investors felt able to hold the same capital as a cushion against losses on both, because they would not lose on both at the same time. However, as Mr Scholes discovered at LTCM and as the entire finance industry has now learnt for itself, at times of market stress assets that normally are uncorrelated can suddenly become highly correlated. At that point the capital buffer implied by VAR turns out to be woefully inadequate.

Even as financial engineers were designing all sorts of clever products on the assumption that markets were efficient, academic economists were focusing more on how markets fall short. Even before the 1987 stockmarket crash gave them their first real-world reminder of markets' capriciousness, some of them were examining the flaws in the theory.

In 1980 Sanford Grossman and Joseph Stiglitz, another subsequent winner of a Nobel prize, pointed out a paradox. If prices reflect all information, then there is no gain from going to the trouble of gathering it, so no one will. A little inefficiency is necessary to give informed investors an incentive to drive prices towards efficiency. For Mr Scholes, it is the belief that markets tend to return prices to their efficient equilibrium when they move away from it that gives the EMH its continuing relevance.

Economists also began to study "institutional frictions" in markets. For instance, the EMH's devotees had assumed that smart investors would be able to trade against less well-informed "noise traders" and overwhelm them by driving prices to reflect true value. But it became clear that there were limits to their ability to arbitrage folly away. Andrei Shleifer, a Harvard economist, among others, pointed out that it could be too costly for informed investors to borrow enough to bet against the noise traders. Once it is admitted that prices can move away from fundamentals for a long time, informed investors may do best by riding the trend rather than fighting it. The trick then is to get out just before momentum shifts the other way. But in this world, rational investors may contribute to bubbles rather than preventing them.

In the early years of the EMH, researchers spent little time worrying about the workings of financial institutions—a weakness of macroeconomics too. In 2000, in his presidential address to the American Finance Association, Franklin Allen, of the University of Pennsylvania's Wharton School, asked: "Do financial institutions matter?" Lay people, he said, "might be surprised to learn that institutions play little role in financial theory." Indeed they might. Mr Allen's explanation was partly that the dominant theories had been shaped at a time when America, especially, was spared financial crises.

Illustration by Brett Ryder

In the past decade or so, financial economists have been paying more attention to institutional questions, such as how bankers should be paid. Many of these researchers broadly accept the EMH, but see their role as uncovering sources of inefficiency that can be addressed to make markets more efficient.

However, a second branch of financial economics is far more sceptical about markets' inherent rationality. Behavioural economics, which applies the insights of psychology to finance, has boomed in the past decade. In particular, behavioural economists have argued that human beings tend to be too confident of their own abilities and tend to extrapolate recent trends into the future, a combination that may contribute to bubbles. There is also evidence that losses can make investors extremely, irrationally risk-averse—exaggerating price falls when a bubble bursts.

Behavioural economists were among the first to sound the alarm about trouble in the markets. Notably, Robert Shiller of Yale gave an early warning that America's housing market was dangerously overvalued. This was his second prescient call. In the 1990s his concerns about the bubbliness of the stockmarket had prompted Alan Greenspan, then chairman of the Federal Reserve, to wonder if the heady share prices of the day were the result of investors' "irrational exuberance". The title of Mr Shiller's latest book, "Animal Spirits" (written with George Akerlof, of the University of California, Berkeley), is taken from John Maynard Keynes's

description of the quirky psychological forces shaping markets. It argues that macroeconomics, too, should draw lessons from psychology.

"In some ways, we behavioural economists have won by default, because we have been less arrogant," says Richard Thaler of the University of Chicago, one of the pioneers of behavioural finance. Those who denied that prices could get out of line, or ever have bubbles, "look foolish". Mr Scholes, however, insists that the efficient-market paradigm is not dead: "To say something has failed you have to have something to replace it, and so far we don't have a new paradigm to replace efficient markets." The trouble with behavioural economics, he adds, is that "it really hasn't shown in aggregate how it affects prices."

Yet EMH-ers and behaviouralists are increasingly asking the same questions and drawing on each other's ideas. For instance, Mr Thaler concedes that in some ways the events of the past couple of years have strengthened the EMH. The hypothesis has two parts, he says: the "no-free-lunch part and the price-is-right part, and if anything the first part has been strengthened as we have learned that some investment strategies are riskier than they look and it really is difficult to beat the market." The idea that the market price is the right price, however, has been badly dented.

Mr Thaler also says that only some of the recent problems were behavioural. Many were due to things that are open to non-behavioural economics, "like better risk analysis, how we identify hidden correlations." It will be no surprise if, thanks to the catalytic power of the bubble and market meltdown, the distinctions between the two camps disappear and a new paradigm emerges.

One economist leading the effort to define that new paradigm is Andrew Lo, of the Massachusetts Institute of Technology, who sees merit in both the rational and behavioural views. He has tried to reconcile them in the "adaptive markets hypothesis", which supposes that humans are neither fully rational nor psychologically unhinged. Instead, they work by making best guesses and by trial and error. If one investment strategy fails, they try another. If it works, they stick with it. Mr Lo borrows heavily from evolutionary science. He does not see markets as efficient in Mr Fama's sense, but thinks they are fiercely competitive. Because the "ecology" changes over time, people make mistakes when adapting. Old strategies become obsolete and new ones are called for.

The finance industry is in the midst of a transformative period of evolution, and financial economists have a huge agenda to tackle. They should do so quickly, given the determination of politicians to overhaul the regulation of financial markets.

One task, also of interest to macroeconomists, is to work out what central bankers should do about bubbles—now that it is plain that they do occur and can cause great damage when they burst. Not even behaviouralists such as Mr Thaler would want to see, say, the Fed trying to set prices in financial markets. He does see an opportunity, however, for governments to "lean into the wind a little more" to reduce the volatility of bubbles and crashes. For instance, when guaranteeing home loans, Freddie Mac and Fannie Mae, America's giant mortgage companies, could be required to demand higher down-payments as a proportion of the purchase price, the higher house prices are relative to rents.

Another priority is to get a better understanding of systemic risk, which Messrs Scholes and Thaler agree has been seriously underestimated. A lot of risk-managers in financial firms believed their risk was perfectly controlled, says Mr Scholes, "but they needed to know what everyone else was doing, to see the aggregate picture." It turned out that everyone was doing very similar things. So when their VAR models started telling them to sell, they all did—driving prices down further and triggering further model-driven selling.

Several countries now expect to introduce a systemic-risk regulator. Financial economists may have useful advice to offer. Many of them see information as crucial. Data should be collected from individual firms and aggregated. The overall data should then be published. That would be better, they think, than a system based solely on the micromanagement of individual institutions deemed systemically significant. Mr Scholes favours relying less on VAR to calculate capital reserves against losses. Instead, each category of asset should have its own risk-capital reserves, which could not be shared with other assets, even if prices had not been correlated in the past. As experience shows, correlations can change suddenly.

Financial economists also need better theories of why liquid markets suddenly become illiquid and of how to manage the risk of "moral hazard"—the danger that the existence of government regulation and safety nets encourages market participants to take bigger risks than they might otherwise have done. The sorry consequences of letting Lehman Brothers fail, which was intended to discourage moral hazard, showed

that the middle of a crisis is not the time to get tough. But when is?

Mr Lo has a novel idea for future crises: creating a financial equivalent of the National Transport Safety Board, which investigates every civil-aviation crash in America. He would like similar independent, after-the-fact scrutiny of every financial failure, to see what caused it and what lessons could be learned. Not the least of the difficulties in the continuing crisis is working out exactly what went wrong and why—and who, including financial economists, should take the blame.

Is Wall Street back to normal?

Keeping up with the Goldmans

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Goldman Sachs's record profits are not a signal to relax

Illustration by S. Kambayashi

TO THE survivors, the spoils. That is the cry going up at Goldman Sachs after it chalked up recession-defying—nay, record-breaking—quarterly profits on July 14th. Minting more than $3 billion in three months, so soon after its own near-death experience in the wake of Lehman Brothers' demise, will enhance Goldman's reputation as Wall Street's overachiever. But it will also strike some as obscene given the scale of public support needed to keep the firm and its peers from buckling last year.

The first half of 2009 was fertile territory for investment bankers as markets rebounded and companies (not least banks themselves) rushed to raise debt and equity. But none of the banks due to report after *The Economist* went to press, not even a resurgent JPMorgan Chase, was expected to come close to Goldman's blowout performance. Having incurred smaller losses than rivals, it is still prepared to deploy risk capital where others fear to tread.

Goldman claims that most of its profit came not from "proprietary" trading, or punting its own money, but by acting as a middleman, making markets for clients in everything from bonds and shares to currencies and commodities. Such business, barely profitable in the boom years, has become a gold mine as competition has dwindled and bid-ask spreads (the money dealers pocket on trades) have ballooned. A bank with the capital and *cojones* to deal mortgage-backed securities issued by Fannie Mae or Freddie Mac can earn 10-15 times more than before the crisis.

Goldman, a dyed-in-the-wool trading firm, is grabbing such opportunities with glee, taking business from once ubiquitous but now reeling rivals such as Citigroup and UBS. It also helps that its arch-rival Morgan Stanley has pulled in its horns. By contrast, Goldman's value-at-risk number—an imperfect but popular measure of risk appetite—hit a new high in the second quarter. But with spreads so high the firm no longer needs to use so much borrowed money to get results. Its leverage ratio has fallen to 14, half its pre-crisis level but still higher than a typical commercial bank's.

Big profits mean big payouts. For the year to date Goldman has set aside $11.4 billion for compensation and benefits, more even than in the halcyon first half of 2007. Its ratio of pay to revenues continues to

hover near the dizzying 50% level that was the norm on Wall Street before the meltdown (see article).

For a firm that probably would have collapsed without government capital, debt guarantees and fast-track approval to turn itself into a commercial bank (not to mention a multi-billion-dollar payout as a counterparty of American International Group), such largesse looks cheeky at best. It has already drawn rebukes on Capitol Hill, even though Goldman has repaid the government's $10 billion preferred-equity investment. "They can't continue along these lines or there will be outrage," thundered Jon Tester, a Democratic senator.

The windfall will eventually dwindle. Goldman and other survivors will continue to benefit from the coming wave of debt issuance by federal, state and local governments. But dealer spreads are sure to shrink as markets normalise and those that have retreated return to the fray. This is likely to be only partially offset by a pickup in businesses tied more closely to economic growth, such as advising on mergers and acquisitions.

Wall Street also faces tighter shackles. Regulators are on the warpath against commodities speculators. A clampdown is coming in credit derivatives; America's Department of Justice has joined those probing that market. The largest financial firms face higher capital requirements. These changes may not bring Goldman back to earth but they will clip its wings.

Markets remain fragile. Even Goldman would struggle to make money without the array of government backstops propping up the system. Others are struggling just to survive. As *The Economist* went to press, CIT, a liquidity-crunched lender to small and middling companies, was scrambling to avert bankruptcy by lining up emergency loans from its debtholders after the government pulled out of rescue talks. Officials had looked at several options but concluded that the firm was too sick to save—and small enough not to pose a systemic threat. But some policymakers worry that the financial system is still in no state to absorb even modest shocks.

And although a few on Wall Street are reaching for the champagne, most Main Street lenders are more inclined to drown their sorrows. Credit-card losses, fuelled by rising rates of unemployment, are at a record high. Mortgage delinquencies have yet to stabilise, with supposedly high-quality "prime" loans now also souring fast and loan-modification schemes having little impact.

Losses are also accelerating in commercial property, on which banks of all sizes loaded up in the fat years. This was the biggest stain on Goldman's ledger, accounting for $1.4 billion of mark-to-market losses. Unnervingly for other banks, many of which carry their commercial-property loans at close to par value, Goldman marks its portfolio at a mere half that.

A Federal Reserve financing programme was recently extended to commercial mortgage-backed securities but many are or will become ineligible under its present rules because of ratings downgrades. Meanwhile, a public-private scheme to take troubled loans off banks' books has stalled, partly because of accounting-rule changes that give the banks more leeway in valuing their assets. A sister programme for toxic securities finally got going this month, albeit in substantially scaled-down form.

Small wonder then that David Viniar, Goldman's finance chief, admitted on a call with analysts that "we are way far away from being out of the woods". The firm may be scooping up market share, but the bigger picture is still far from pretty.

Banks and bonuses

Going overboard

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Are investment banks run for employees or shareholders?

IT WAS once famously asked of Wall Street: "Where are the customers' yachts?" Shareholders of investment banks have not seen much of the spoils either, given the events of the past two years. As business booms once more, rather than reward their owners with an extra big chunk of profits, most investment banks seem likely to favour their employees again. In the case of Goldman Sachs, shareholders received $4.4 billion of profits during the first half of this year while staff were allocated $11.4 billion in pay and bonuses, equivalent to about half of the firm's net revenues.

Banks defend their model by arguing that they have to pay top dollar to secure the best employees, who maximise profits for shareholders. If they paid less, profits would be lower. For Goldman there may be some truth in this. In the first half of 2009 shareholders still earned a healthy return on equity of 19%. And over the decade to the end of 2008, even though cumulative compensation was double profits, return on equity averaged 20%. Furthermore, since a chunk of bonuses are paid in stock and staff cannot sell their shares immediately, their interests are to some extent aligned with those of shareholders.

There are several holes in the industry's argument, however. One is that when investment bankers owned the banks themselves, partners demanded higher returns on their equity than public shareholders now get. In the three years before the bank floated in 1999, Goldman partners earned returns on their capital of about 50% each year.

More importantly, the industry-wide practice of paying out about half of net revenues to employees looks a lot less palatable for shareholders once mediocre or bad banks are taken into account. This is a risky industry: two of America's five big stand-alone investment banks collapsed during the crisis. And when things go wrong employees do not always take their share of the pain.

Lehman Brothers made losses in the two quarters before it collapsed yet continued to accrue a compensation pot not far off the levels of 2007. Shareholder returns over the entire cycle look a lot worse when the failures are included. Lehman paid out $55 billion to employees in the decade to the end of 2008. Shareholders earned cumulative profits of zero, including the loss of all of their capital when the firm failed (see chart).

Banks pay low dividends, and when they get into trouble the capital that shareholders have retained in the firm typically gets wiped out. Employees have taken money out of their firms each year. It may be time for the owners of banks to mutiny over the bounty.

Private placements in Asia

Silent disaster

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Tens of billions of dollars in financing arrangements are in trouble

ASIA may be the bounciest part of the world economy, but many investors in the region are feeling decidedly deflated. The source of their misery is the private-placement market, which offered great riches before the crisis but now provides little protection after it. The scale of the mess is unclear but a rare window into one of these transactions opened in May when half a dozen Western hedge and private-equity funds were named in various legal actions filed in London and Jakarta by shareholders of CP Prima, a large Indonesian agricultural company.

In 2007 the funds provided $200m to finance CP Prima's consolidation of the region's shrimp-farming operations. The financial crisis and a devastating virus sent CP Prima's share price spiralling downward. The firm's controlling shareholders are now demanding billions of dollars in damages from its bondholders for taking control of a Singaporean special-purpose vehicle called Red Dragon that had been used as a conduit for the loans.

Many more of these kinds of conduit deals are under pressure as companies flail and investors debate whether to restructure their debts. Insiders reckon that at least 100 such placements were done for Chinese companies, another 50 for companies in Indonesia and a smattering more for companies in Thailand, the Philippines and Malaysia. Tom Wadham of Debtwire, a news service, says the relatively firm data on $7 billion-worth of transactions his firm has tracked constitutes only the most high-profile and broadly syndicated deals. He believes the size of the market must be in the tens of billions of dollars, and that more than 90% of transactions are probably now in deep trouble.

The roots of the current mess date back to 2005 when Asia's boom attracted many Western hedge and private-equity funds. They soon discovered there was little that could be purchased on public markets and even less, given the amount of money flooding the market, that could provide a substantial return. At the same time local companies were eager to raise money for capital investment but faced bureaucratic impediments to issuing public securities. This was particularly true in China, where every public offering of debt or equity requires not only a government endorsement of a company's specific plans but also a long wait in a queue to raise money. Other Asian countries were a bit easier.

As a result, financing structures were developed that typically used an investment entity in another location—usually Singapore, Hong Kong, the Cayman Islands or the British Virgin Islands—that could receive money and then pass it on to the operating entities, wherever they might be. Avoiding a direct tie between investors and the investment cut out the local regulators. But it also meant creditors had no security interest in the companies themselves and little protection in the event of a default.

In exchange for these risks there was the prospect of great returns. In the case of CP Prima, investors in the Red Dragon vehicle could swap the bonds for shares at a steep discount after three years. If CP Prima's share value was merely stable, the annualised return would exceed 14%, a huge return at the time.

A similar structure was widely used by companies that planned to go public in the near future: a low-yielding convertible bond would be issued that could be swapped for cheaply priced shares prior to an initial public offering (IPO). For the global investment banks that arranged these deals, it was all hugely lucrative. They received fees of up to 8% for a private placement and could expect another 2% in fees in the likely event of an IPO.

The crisis leaves many hedge funds and private-equity firms sitting on heavy losses. The question now is where the red ink is hiding. One theory is that some write-offs have already been buried in the welter of losses taken during the crisis. Another theory is that these investments, being both private and illiquid, have yet to be marked down. If so, the hope is that a recovery, and the incentive firms have to keep

relations with creditors cordial so they can raise money in the future, will offer a hidden rescue to a silent disaster.

Buttonwood

Dropping a brick

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From The Economist print edition

Investors may be too complacent about the outlook for property

Illustration by S. Kambayashi

TWO bear markets in the past decade have made many investors reconsider their attitude towards equities. The argument that shares are the best investment for the long run no longer sounds quite so convincing. Property is not yet the subject of such disillusionment. Already, in the British residential market at least, estate agents are talking as if the crisis is over. Many people seem to assume that once the recession has finished, property prices can resume their traditional upward course.

But if equities are doomed to struggle, property will surely follow. The terrible performance of the Japanese equity market over the past 20 years is well known. It is easy to forget that property prices have suffered almost as much. Japanese land prices are still 58.5% below their 1991 peak, and indices of residential and commercial property are 44.3% and 73% below their highs respectively.

One should expect a rough link between equities, property markets and economic growth. Neil Turner of Schroders, an asset-management group, says a simple model suggests that property returns should equal the starting yield plus rental growth. In turn, rental growth is linked to income growth and thus to nominal GDP. On the same basis, equity returns should be equivalent to dividend yield plus dividend growth, with the latter linked to GDP.

Over the past decade, however, property seems to have performed much more strongly than equities. Only in 2008 did the IPD index of global commercial property show a negative return. But the 10.1% fall (in dollar terms) was a lot better than the 40.3% plunge in the MSCI world-equities index. Over the previous decade, from 1998 to 2007, an investor who put a notional $1,000 in the IPD index would have trebled his money (assuming he reinvested his income) while an equity portfolio tracking the MSCI index would have merely doubled.

Part of that outperformance may be the result of the stratospheric valuations on which equities traded in the late 1990s. Property values started from a much more reasonable base. But property's relative stability may be an illusion caused by an illiquid market; values have simply not been marked down as much as they should have been.

The fact that British property returns were the second-worst of all countries in the IPD database in 2008 was not just down to a lousy economy. It was because British companies tend to be quicker to adjust values to reflect recent transactions. Other countries are slower to act, but the mask occasionally slips. Earlier this year the John Hancock tower, a Boston office building, was auctioned for $660m. It had been bought for $1.3 billion in 2006.

The Hancock deal was a distressed sale, of course. But other such deals will surely follow. In a recession vacancy rates rise, rental income stagnates or falls, and financing is both more expensive and harder to renew. David Skinner of Aviva Investors, a fund-management group, says that property prices since 2000 have been driven not by fundamentals but by the availability of credit.

Property was indeed a great investment at a time when financing was easy and recessions were occasional and mild. But that world has disappeared for a while. Even low interest rates may not help, as the Japanese example has illustrated over the past 20 years.

The naive belief that American house prices could not fall at the national level has been exposed by the current crisis. The belief that property prices must rise over periods of a decade or more may also prove to be false. Figures from Robert Shiller of Yale University show that real American house-prices were lower in 1945 than they were in 1900, for example. In a world of low inflation that means they could easily fall in nominal terms.

What about the argument that the result of this crisis will inevitably be inflation? Surely property would be a good hedge against such an outcome, as rents would be expected to keep pace with higher prices in the long run?

It sounds good in theory, but in practice the result of inflation would probably be a one-off rise in rental yields caused by a sharp fall in property prices. The 1974-1976 inflationary downturn in Britain saw cumulative commercial-property losses of 45%; yields rose from 5.7% to 8.7% between 1973 and 1975. Any increase in inflation would also lead to higher interest rates, causing further problems for leveraged investors. A strong economy is a far better backdrop for property than inflation ever could be.

The Big Mac index

Cheesed off

Jul 16th 2009
From The Economist print edition

Burgernomics points to uncompetitive currencies in continental Europe

Value Meals

The hamburger standard

	Big Mac prices		Implied PPP† of the dollar	Actual dollar exchange rate July 13th	Under(-) / over(+) valuation against the dollar, %
	In local currency	In dollars*			
United States‡	$ 3.57	3.57			
Argentina	Peso 11.5	3.02	3.22	3.81	-15
Australia	A$ 4.34	3.37	1.22	1.29	-6
Brazil	Real 8.03	4.02	2.25	2.00	+13
Britain	2.29	3.69	1.56§	1.61§	+3
Canada	C$ 3.89	3.35	1.09	1.16	-6
Chile	Peso 1750	3.19	490	549	-11
China	Yuan 12.5	1.83	3.50	6.83	-49
Czech Republic	Koruna 67.92	3.64	19.0	18.7	+2
Denmark	DK 29.5	5.53	8.26	5.34	+55
Egypt	Pound 13	2.33	3.64	5.58	-35
Euro Area**	€ 3.31	4.62	1.08††	1.39††	+29
Hong Kong	HK$ 13.3	1.72	3.73	7.75	-52
Hungary	Forint 720	3.62	202	199	+1
Indonesia	Rupiah 20900	2.05	5,854	10,200	-43
Israel	Shekel 15	3.77	4.20	3.97	+6
Japan	Yen 320	3.46	89.6	92.6	-3
Malaysia	Ringgit 6.77	1.88	1.90	3.60	-47
Mexico	Peso 33	2.39	9.24	13.8	-33
New Zealand	NZ$ 4.9	3.08	1.37	1.59	-14
Norway	Kroner 40	6.15	11.2	6.51	+72
Peru	sol 8.056	2.66	2.26	3.03	-25
Philippines	Peso 99.39	2.05	27.8	48.4	-42
Poland	Zloty 7.6	2.41	2.13	3.16	-33
Russia	Ruble 67	2.04	18.8	32.8	-43
Saudi Arabia	riyal 11	2.93	3.08	3.75	-18
Singapore	S$ 4.22	2.88	1.18	1.46	-19
South Africa	Rand 17.95	2.17	5.03	8.28	-39
South Korea	Won 3400	2.59	952	1,315	-28
Sweden	SKR 39	4.93	10.9	7.90	+38
Switzerland	CHF 6.5	5.98	1.82	1.09	+68
Taiwan	Taiwan $ 75	2.26	21.0	33.2	-37
Thailand	Baht 64.49	1.89	18.1	34.2	-47
Turkey	lire 5.65	3.65	2.45	1.55	+2
United Arab Emirates	Dirhams 10	2.72	2.80	3.67	-24
Colombia	Peso 7000	3.34	1,961	2,096	-6
Costa Rica	Colones 2000	3.43	560	583	-4
Estonia	Kroon 32	2.85	8.96	11.2	-20
Iceland	Kronur640	4.99	179	128	+40
Latvia	Lats 1.55	3.09	0.43	0.50	-13
Lithuania	Litas 7.1	2.87	1.99	2.48	-20
Pakistan	Rupee 190	2.30	53.2	82.6	-36
Peru	New Sol 8.056	2.66	2.26	3.03	-25
Philippines	Peso 99.39	2.05	27.8	48.4	-42
Sri Lanka	Rupee 210	1.83	58.8	115	-49
Ukraine	Hryvnia 14	1.83	3.92	7.66	-49
Uruguay	Peso 61	2.63	17.1	23.2	-26

*At current exchange rates †Purchasing-power parity; local price divided by price in United States ‡Average of New York, Chicago, Atlanta and San Francisco §Dollars per pound **Weighted average of prices in euro area ††Dollars per euro

Sources: McDonald's; *The Economist*

WHEN demand is scarce and jobs are being lost, no one relishes a strong currency. A country with an uncompetitive exchange rate will struggle to sell its wares abroad and will also cede its home market to foreign firms. A weak exchange rate, by contrast, encourages consumers to switch from pricey imports to cheaper home-produced goods and services. So which countries has the foreign-exchange market blessed with a cheap currency, and which has it burdened with a dear one?

The Economist's Big Mac index, a lighthearted guide to valuing currencies, provides some clues. It is based on the theory of purchasing-power parity (PPP), which says that exchange rates should equalise the price of a basket of goods in each country. In place of a range of products we use just one item, a Big Mac hamburger, which is sold worldwide. The exchange rate that leaves a Big Mac costing the same

in dollars everywhere is our fair-value benchmark.

The dollar buys the most burger in Asia. A Big Mac costs 12.5 yuan in China, which is $1.83 at today’s exchange rate, around half its price in America. Other Asian currencies, such as the Malaysian ringgit and Thai bhat, look similarly undervalued. Businesses based in continental Europe have most to be cheesed off about. The Swiss franc remains one of the world’s dearest currencies. The euro is almost 30% overvalued on the burger gauge. Denmark and Sweden look even less competitive.

Care is needed when drawing quick conclusions from fast-food prices. The cost of a burger depends heavily on local inputs, such as rent and wages, which are not easily arbitraged across borders and tend to be lower in poorer countries. So PPP gauges are better guides to misalignments between countries with similar incomes.

On that basis, the markets have been kindest to British exporters. A year ago the pound was overvalued by more than a quarter on the Big Mac gauge. Now it is close to its fair value against the dollar and looks cheap against the euro. That shift has upset some other EU countries that had relied on selling to spendthrift British consumers. But after years of struggling with an overvalued currency, British firms will feel they deserve a little mercy.

Reforming finance: Accounting standards

Marks and sparks

Jul 16th 2009
From The Economist print edition

Accountants draw up new rules for financial firms. The latest in our series

REWRITING laws in a hurry is never a great idea, but that is exactly what the International Accounting Standards Board (IASB), which sets rules for beancounters outside America, has been forced to do. One of the casualties of the credit crisis has been the idea of fair-value accounting—the practice of valuing financial assets, mainly securities, at market prices or the closest thing there is to them. The idea that accounting caused the crisis is specious, but Europe's politicians, egged on by banks that took huge write-downs when market prices swooned, have nonetheless lashed out. The message has been pretty clear: make banks' balance-sheets look better, or else. America's rulemaker, the Financial Accounting Standards Board (FASB), has been excoriated by Congress and is back at the drawing-board too.

Unpleasant though the political mood music is, change is needed. The existing standards are a shambles, a patchwork of inherited rules riddled with escape clauses. They mix mark-to-market values with the more traditional practice of carrying assets at their cost and impairing them only when managers and auditors think fit. There are also several different ways of recognising losses. The result is that the balance-sheets of different banks are not always directly comparable.

IASB's proposed solution, announced on July 14th, is to put all financial assets into two buckets. Loans and securities which share the characteristics of loans—in other words, assets that derive their value only from interest and repayment of principal—will be held at cost, provided banks can show they will hold them for the long term. Everything else, including equities, derivatives and more complicated securities, will be held at fair value. Companies will be allowed to start applying the new rules from the end of this year, and will be obliged to by 2012.

This is far simpler than the existing system. But according to one bank's finance chief, defining the boundary between the two types of assets is likely to prove tricky. For example, IASB is likely to allow only the very top tranches of asset-backed securities to be classified as loans. That could reduce demand for tranches of nearly equivalent risk, as firms become less keen to hold them. Some insurance companies, meanwhile, are reported to be worried about holding all equities at market prices.

Any boundary will inevitably be somewhat arbitrary, however. The end result does look sensible: simple things will be held in more opaque loan books and fiddly things held at market prices. It is hard to judge whether the overall proportion of assets held at fair value will fall, but it seems highly likely. Anything else would result in an outright punch-up with some European governments.

It is this political tension which is the real problem now for standards-setters. Previous battles over accounting for pensions and share options were won in the face of great hostility. It would be hard to engage in such battles now. The best defence against politicking is to continue to merge international and American accounting into a single rulebook governed by an independent body. This is meant to happen over the next few years anyway, but American rulemakers have been dragging their heels. IASB's pragmatic proposals may make consensus easier to reach.

Economics focus

A partial marvel

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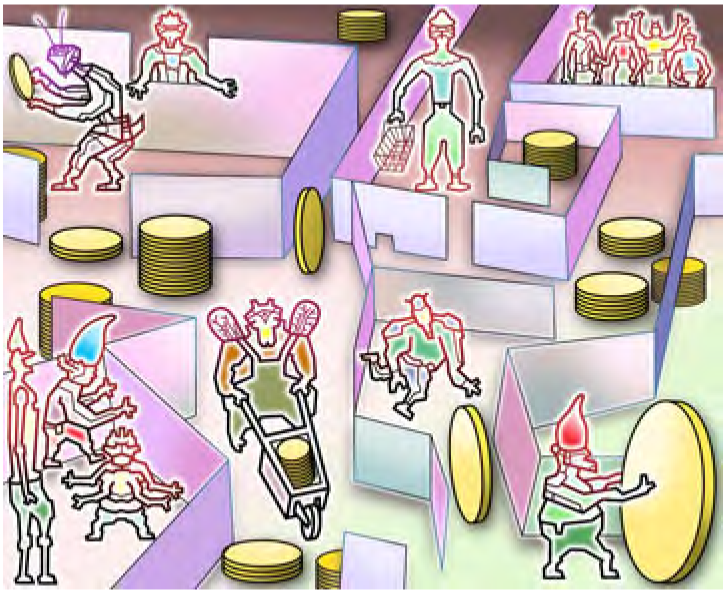
From The Economist print edition

Microcredit may not work wonders but it does help the entrepreneurial poor

Illustration by Jac Depczyk



MICROCREDIT looks like a miracle. It involves providing unsecured small loans to poor people in developing countries whom most banks would turn away. Yet these small borrowers almost always repay their loans (and the fairly steep interest charges) on time, which suggests that they find productive uses for the money. The industry's backers make some big claims as a result: Mohammad Yunus, the founder of Grameen Bank in Bangladesh and the father of microfinance, reckons that 5% of Grameen Bank's clients exit poverty each year. Yet economists point out that there are surprisingly few credible estimates of the extent to which microcredit actually reduces poverty.

This would not matter too much if all microfinance funding were raised via the market (as an increasing proportion is). As long as investors were satisfied with their returns, there would be no cause for concern. Yet despite growing interest from private investors, 53% of the $11.7 billion that was committed to the microfinance industry in 2008 still came at below-market rates from aid agencies, multilateral banks and other donors. Given that there are other things that aid money could be spent on, and that the rationale for subsidising microcredit is its effectiveness as an anti-poverty tool, it is important for donors to know whether it has the advertised effects.

Measuring the impact of microcredit is complicated by the fact that the counterfactual—what would have happened to a person who borrowed from a microlender if he had not done so—cannot easily be tested. Many early studies compared borrowers with non-borrowers. But if borrowers are in any case more entrepreneurial than those who do not borrow, such comparisons are likely to overstate hugely the effect of microcredit.

Worries of this nature are not mere nitpicking. One study surveyed 1,800 families in rural Bangladesh and found that an impressive 62% of school-age sons of those who borrowed from Grameen Bank were in school, compared with 34% of the sons of non-borrowers. Advocates argued that this showed that microcredit helped increase school enrolment. But a comparison with people of similar backgrounds in villages without access to microcredit showed that the difference was because people who were already more likely to have children in school were also those who signed up for microcredit. Even comparisons between areas with and without microcredit may be misleading, because microlenders naturally choose to work in areas where their prospects of success are the greatest.

The pervasiveness of these self-selection issues has led researchers to devise experiments that allow them to ensure that participation in a programme is determined essentially by chance. Two new papers* apply this idea to measure the effect of access to microcredit. Researchers from the Poverty Action Lab at the Massachusetts Institute of Technology (MIT) worked with an Indian microfinance firm to ensure that 52 randomly chosen slums in the city of Hyderabad were given access to microfinance, while 52 other slums, which were equally suitable and where the lender was also keen to expand, were denied it. This allowed the researchers to see clearly the effect of microcredit on an entire community. Dean Karlan of Yale University and Jonathan Zinman of Dartmouth College carried out a similar exercise in the Philippines, this time at the level of the individual borrower. They tweaked the credit-scoring software of a microfinance firm so that only a random subset of people with marginal credit histories were accepted as clients. These clients could then be compared with those who sought credit but were denied it.

Broadly speaking, neither study found that microcredit reduced poverty. There was no effect on average household consumption, at least within a year to 18 months of the experiment. The study in the Philippines also measured the probability of being under the poverty line and the quality of food that people ate, and again found no effects. Microcredit may not even be the most useful financial service for the majority of poor people. Only one in five loans in the Hyderabad study actually led to the creation of a new business. Providing people with safe places to store their (small) savings may help them more in the long run.

Small and perfectly formed?

That said, microcredit did have discernible effects. In India, people in the slums that had access to microcredit were more likely to cut down on things like tobacco and alcohol in favour of durable goods (particularly items such as pushcarts or cooking pans that are used heavily by traders and food-stall owners). One reason average consumption failed to increase may therefore be that more people were diverting some of their own income into starting or expanding their businesses. Microcredit clearly allowed more people to overcome the barrier posed by start-up costs. The MIT researchers found that as many as one-third more businesses had opened in slums which had a microcredit branch. This may mean that even though there was no measurable impact on poverty during the study period, there may well be some over a longer time-frame as these businesses prosper.

Tiny loans are unlikely to be enough to allow these businesses to grow to an efficient scale, of course. But the role of microcredit in allowing people to signal their creditworthiness is valuable, especially if their success makes banks more willing to lend them larger sums and leads to even more economic activity. By being willing to take a risk on entrepreneurial sorts who lack any other way to start a business, microcredit may help reduce poverty in the long run, even if its short-run effects are negligible.

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* "The Miracle of Microfinance? Evidence from a Randomised Evaluation" by Abhijit Banerjee, Esther Duflo, Rachel Glennerster and Cynthia Kinnan, May 2009. "Expanding Microenterprise Credit Access: Using Randomized Supply Decisions to Estimate the Impacts in Manila" by Dean Karlan and Jonathan Zinman, July 2009.

Human spaceflight

Over the moon?

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From The Economist print edition

On the 40th anniversary of the first moon landing, America wonders whether to go back there

AFP

IT WASN'T supposed to be like this. Five years ago, in a flurry of manifest destiny, George Bush outlined a plan to return Americans to the moon in 2020, with an option on going to Mars later. Now that plan is the subject of a rather un-American bout of introspection and self-examination. Instead of back-slapping and sky-punching there is hand-wringing and uncertainty. At the behest of Barack Obama's newly empowered Office of Science and Technology Policy (OSTP), NASA, America's space agency, is submitting to an independent review of its human-spaceflight plans in order to determine their future.

In truth, NASA has never really recovered its direction since the triumph of the Apollo project. The zenith of that project was 40 years ago on July 20th 1969, when Neil Armstrong stepped out of *Apollo 11*'s lunar module onto the Sea of Tranquillity, and promptly fluffed his lines. The cancellation of Apollo three years later started the slide, and the space shuttles that were supposed to fill the gap failed to become the workaday vehicles that had been promised. The agency's probes have visited all of the solar system's planets and it has done a lot of important science. But its manned space programme has never got back the pizzazz of 1969.

This year, though, has been a particularly difficult one for NASA. It started with the incoming administration asking some hard questions, such as how much money could be saved by cancelling various bits of the spacecraft that the agency plans to use to replace its fleet of ageing shuttles—which, among other things, provide America's only direct link with the International Space Station. The shuttles are due to retire next year, and there is already consternation about the gap between that retirement and the arrival of their successor. In the interim, NASA will be forced to use a Russian stand-in, Soyuz, in order to keep the space station supplied and afloat, as it were. This has become even more politically awkward since the war last year between Russia and Georgia.

The starting point for the review is a simple one: money. Mr Obama's administration, like every other new government, wishes to impose its own spending plans, and human spaceflight has never been high on its list of priorities. The existing plan for human spaceflight sets NASA on a path that will lead it to consume what one insider estimates to be around $100 billion before the programme is complete. It seems entirely prudent, therefore, for the administration to examine whether this is money well spent.

The letter to NASA requesting the review, from John Holdren, the director of the OSTP, refers to a trajectory for the future of human spaceflight that is "safe, innovative, affordable and sustainable". Within those four little words, though, lie a number of substantial challenges. For example, as currently designed, NASA's plans for a system of rockets to replace the shuttle (known collectively as Ares, the Greek name for Mars) do not fit within the funds that are available, and have been criticised for showing too little innovation and even less progress. NASA's role, some argue, should be the whizzier business of novel plasma-drives and nanotech-based heat shielding—not "Apollo on steroids" as some people have derisively described Ares. Nor is there any sense of how the proposed moon base that would eventually be built, supposedly as a stepping stone to Mars, can be supported financially.

Contact light. OK. Engine stop

The difficulty, as ever, is to make the agency properly serve the public that pays for it. Shortly before he was appointed to the review panel, Jeff Greason, the head of a small spaceship company called XCOR Aerospace, said, possibly prophetically: "There is a question that gets asked far too seldom, which is why do we have NASA?"

Few are suggesting that NASA be eliminated, but such questions reflect the struggle for purpose that it has had since the end of Apollo. The legislation that created it speaks of the expansion of human knowledge of the atmosphere and space, and the improvement of the usefulness and performance of aeronautical and space vehicles. Its mission is not human exploration for its own sake, nor off-planet colonisation, yet human spaceflight consumes a large chunk of the budget. It is interesting, then, that the review is also instructed to determine the appropriate amount of robotic activities needed to make human spaceflight productive and affordable over the long term. Such language allows questions to be asked such as whether it is possible to achieve more of NASA's goals with fewer human missions.

Give me the moon, O Lord, but not yet

Some people—including Buzz Aldrin, the second man to step out of the *Apollo 11* lunar module—have taken the opportunity to wonder whether returning to the moon is such a good idea anyway. Dr Aldrin, whose book is reviewed here, would prefer NASA to aim for Mars directly. He questions the whole "moon to Mars" concept. And he is right. If the real goal is to fly to Mars, there is no reason at all to go via the moon.

At the moment a shift in priorities that would lead to a direct Mars mission seems unlikely. Some commentators think the panel will go as far as reaffirming the concept of returning to the moon when it completes its whirlwind review this August. Others argue that the administration is simply not committed to human spaceflight and wants to do other things with its money, and that the composition of the review panel indicates that it is merely intended to divert political flak.

Anyone versed in the dark art of commitology, the study of committees, will know that who you appoint to an "independent" panel matters, as do its terms of reference. This panel is commonly referred to as the Augustine committee, after its chairman Norman Augustine, who was once head of Lockheed Martin, one of America's largest aerospace companies. Mr Augustine was also the head of a committee that met in 1990 to discuss NASA's priorities. That committee called for space science to be given a far higher billing—above and beyond that accorded to manned missions and space stations—and resulted in a lot of cheap but effective scientific missions being launched. Although the scope of Mr Augustine's latest review does not allow for such an explicit conclusion this time, it would still be able to place more emphasis on private-sector human spaceflight and demand more unmanned missions to the moon.

Even if the eventual conclusion is that astronauts should return to the moon, though, the means of getting them there must still be decided. Frank Sietzen, a space analyst and writer, reckons a lack of money will mean the Ares project "will be on life support by the end of summer". One alternative to Ares, proposed by the United Launch Alliance, a joint venture of Lockheed Martin and Boeing, is to use modified versions of their existing Delta 4 and Atlas 5 rockets both to go to the moon and to resupply the space station, but at lower cost. And if Ares is cancelled another winner may be SpaceX, a small Californian firm that is building a series of rockets called Falcon. These will be able to fly cargo to the International Space Station—and, if all goes well in the future, people.

SpaceX differs from Lockheed and Boeing in that Falcon is a speculative venture rather than having been commissioned (as Delta and Atlas were) by the government. Many see this sort of true private

enterprise, rather than the taxpayer-assisted sort, as the way forward in space. And if that is the case, then whatever the Augustine committee's conclusions are, the eternally difficult question of what NASA is for will soon have to be asked again.

Biofuels from algae

Craig's twist

Jul 15th 2009
From Economist.com

Algae inch ahead in the race to produce the next generation of biofuels

Eyevine

And for my next trick

WHEN BP branded itself as "Beyond Petroleum", and the fashionable colour among oil companies was green, Exxon Mobil stood aloof from the rush to embrace alternative sources of energy. Indeed Rex Tillerson, the firm's chief executive, once humorously referred to biofuels as "moonshine". Now, when some of the enthusiasts are having second thoughts and scaling back on alternatives, Exxon seems to be going the opposite way yet again. On July 14th the oil giant said it would put $300m into what is probably the biggest effort so far to create a new generation of biofuels—with a further $300m to come if things go well.

The beneficiary of this largesse is Synthetic Genomics, a firm based in San Diego that is the commercial vehicle of Craig Venter (pictured above). Dr Venter may be familiar to readers as the former head of Celera Genomics, which ran a privately financed version of the human genome project during the late 1990s, and before that as the leader of the team which produced the first genetic sequence of a living organism (a bacterium called *Haemophilus influenzae*). In this case, though, the money will be thrown at neither people nor bacteria, but algae.

At the moment, most biofuels are either ethanol, usually made from sugarcane or maize, or biodiesel, made from plant oils. But many people hope that will no longer be true in ten years' time. By then, the expectation is, biofuels will chemically resemble the stuff that pours out of existing oil refineries—ie, hydrocarbons. The question is, how do you get there from here?

Dr Venter thinks he knows the answer. He proposes the industrial-scale culturing (biomanufacturing, as he describes it, rather than farming) of single-celled algae that have been genetically engineered to turn out fuel-ready hydrocarbons. He is by no means the only person to be working on the idea of turning algae into biofuels, but he has one or two particular ideas about how to do it. The most important of these is to get the algae to secrete their products into the culture medium in which they are being raised. Many algae make oil, which they store as a foodstuff against an uncertain future. But they do not squirt it out of their bodies. That would be pointless.

Other firms are working on ways to break up the cells of oil-rich algae to get at the oil. Dr Venter, however, has succeeded in engineering a secretion pathway from another organism into experimental algae. These algae now release their oil, which floats to the surface of the culture vessel. That is why he refers to the process as biomanufacturing. It is not farming, he reckons, because the algae themselves are never harvested (though it may be necessary to cull them if they become too abundant).

The next trick, which Exxon's money will help pay for, is to tweak the biochemical pathway that makes the algal oil (which is known, technically, as a triglyceride, and has oxygen atoms in it as well as carbon and hydrogen) so that the oxygen-containing parts of the molecules are snipped off and a pure hydrocarbon is left. After that, it will be a question of looking through the thousands of species of algae around to see which would make the best "platform" for the new technology. The ideal species will be able to stand up to intense illumination (more light means faster photosynthesis) and heat (for the high levels of sunlight required will also warm things up). It will also need to be resistant to viruses, which will otherwise be a big threat to such a concentrated population of identical organisms. And if no suitable species exists, then Synthetic Genomics's researchers will take the desirable characteristics from several and create what is, in effect, a new one.

The other raw material for photosynthesis, carbon dioxide, will be supplied as the exhaust from industrial plants such as power stations, oil refineries and natural-gas processors. That this will be captured before it can get into the atmosphere and promote climate change will be a bonus. The process will not be truly carbon-neutral (for that, the CO_2 would have to come out of the atmosphere, and if the algae could use only the limited amount of the gas in natural air, they would not grow fast enough) but each carbon atom will have been made to do double duty in a fuel before it finally escapes. The result, if all goes well, will be a mixture of hydrocarbons that can be fed into the stage of the oil-refining process just before petrol and diesel emerge from the stills, and at a price that competes with the equivalent chemical mixture produced by traditional methods.

Dr Venter reckons that even with existing technology, it should be possible to turn out ten times more fuel per hectare than can be garnered from maize. That is not a completely fair comparison, of course, as growing algae is far more capital intensive, and requires the plants to be force-fed with CO_2. But it can be done on land that is unsuitable for agriculture, as long as a source of CO_2 is available.

In the end, that might be the limiting factor, for not all power stations, oil refineries and so on are suitably located for biomanufacturing of this sort. That said, if the process really can be made to work, CO_2 would go from being a polluting waste product to a valuable raw material, and it might even become worthwhile building systems to capture it and pipelines to ship it around. That really would be ironic.

The search for dark matter

Ethereal yet weighty

Jul 16th 2009
From The Economist print edition

Two new ways to detect the elusive stuff of the universe

Science Photo Library

Embedded in darkness

MOST of reality appears to be missing. Physicists reckon that the missing matter must be there, but that it is dark. Finding the stuff is damned tricky because dark matter, by definition, cannot be seen. So some of those physicists have been busy trying to devise ways of glimpsing it indirectly—and two groups of them now think their methods are ready to test.

One reason to believe dark matter exists is that galaxies rotate at such speeds that they would fly apart without it, or so the argument goes. The fact that galaxies persist suggests they are held together by the gravitational pull of something invisible—in other words, dark matter. This stops stars being shed from their edges.

Claims to have spotted dark matter have so far rested mostly on evidence gathered by looking at collisions between clusters of galaxies. Some of these appear to have separated dark matter from its visible counterpart. Three months ago, however, a team of physicists reported subatomic evidence. They think they have seen an abundance of high-energy positrons, the antimatter versions of electrons, coming from space, and they speculate that this, too, is a sign of dark matter.

One possible explanation for these positrons is the mutual annihilation of the matter and antimatter forms of a type of dark matter called weakly interacting massive particles, also known as WIMPs. Calculations suggest that when WIMPs and antiWIMPs meet, one product will indeed be a lot of positrons.

Now a team led by Michael Kuhlen of the Institute for Advanced Study in Princeton, New Jersey, has devised an explanation that lends weight to this idea. For the past few years Dr Kuhlen and his colleagues have been working on a computer model of the halo of dark matter in which the Milky Way (the Earth's home galaxy) is thought to be embedded. Their simulation starts about 50m years after the Big Bang, when the first galaxies formed, and calculates the interactions of a billion WIMPs over the intervening 13.7 billion years.

The researchers included in their model a hitherto-neglected effect proposed by a German physicist, Arnold Sommerfeld, in the 1930s. The Sommerfeld effect, a quantum-mechanical process that makes particles more likely to interact with one another in some circumstances and less likely in others, is mostly ignored in particle physics because it applies only in a limited range of conditions. However, one of those is when a particle is slow-moving and massive. As that describes WIMPs rather well, Dr Kuhlen and his colleagues included it in their model. After running their simulation on a supercomputer, they found that dark matter should annihilate much more readily than had previously been thought. They report their work in the current edition of *Science*.

If they are correct, it would explain the newly observed abundance of high-energy positrons. Moreover, they also point out that there should be a second signal from annihilating dark matter, in the form of gamma rays coming from the Milky Way's halo. It should be relatively straightforward to detect these using satellite-based telescopes such as *Fermi*, which was launched last year.

Meanwhile Pierre Colin of the Max Planck Institute for Physics in Munich and his colleagues reckon that the shadow of the moon could be used to help work out whether the abundance of positrons actually does come from annihilating dark matter, using telescopes that look for Cherenkov radiation—flashes of light in the sky—that are created when cosmic rays, in the form of high-energy electrons and positrons,

hit the upper atmosphere.

As Dr Colin described on July 9th to the International Cosmic Ray Conference held in Lodz, Poland, the moon blocks electrons and positrons as effectively as it blocks light. This creates, as it were, electron and positron shadows. But because these particles are electrically charged, they also interact with the Earth's magnetic field. And since their charges are opposite, the interaction deflects the two sorts of particles in different directions.

The result is that the electron shadow and the positron shadow are separated. Normally, it is impossible to distinguish Cherenkov radiation generated by positrons from that created by electrons. However, when the moon is between the telescope and the source of the cosmic rays, Dr Colin and his colleagues reckon that it will be possible to separate the two by looking at the edges of the shadows. That would enable physicists to see whether the number of high-energy positrons matches the theory's expectation and thus, appropriately, use shadows to cast light on the existence of dark matter.

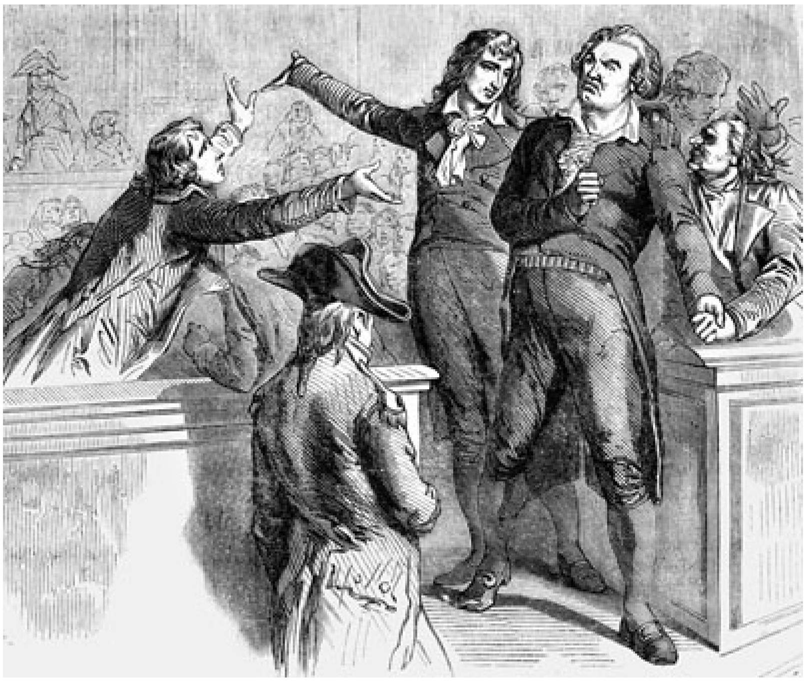
Economist.com BOOKS & ARTS

Devoured by his own creation

Jul 16th 2009
From The Economist print edition

A revolutionary who tried to believe in moderate-minded terrorism

Bridgeman



Danton: The Gentle Giant of Terror. By David Lawday. *Jonathan Cape; 294 pages; £20. To be published in America by Grove Atlantic at the end of 2010*. Buy from Amazon.co.uk

A SUCCESSFUL 27-year-old barrister in King Louis XVI's Paris council in 1787, Georges-Jacques Danton possessed a loving wife and a good income, plus a doting mother in Arcis-sur-Aube, his native home in north-eastern France. His contentment would be short-lived. France was bankrupt, and its monarchy an affront to the Enlightenment. By 1789 revolution was in the air and bourgeois gentlemen such as Maître d'Anton (as he called himself at the time) needed to take sides. Imbued with liberal and classical ideals, he joined the revolutionaries. "I saw an irresistible tide sweep by," he explained.

Three years later Danton had led the overthrow of the French monarchy, been appointed first minister of France and was the dominant voice in the National Convention. In 1793 he voted for the king's execution and was directing the war against disgusted European powers. For the *sans-culottes* of Paris, he was the embodiment of the revolution. But by the following year he was dead, sentenced to the guillotine by his own tribunal (our lithograph shows him at his trial, together with his friend, Camille Desmoulins).

What drove the ugly and dyslexic Danton, suckled by cows in rural Champagne, to rise and fall so dramatically? This is not an easy question. Despite his impact, Danton is enigmatic: his appalling penmanship meant he wrote practically nothing.

David Lawday, whose previous book was a life of Talleyrand and who used to be a journalist at *The Economist*, provides a gripping story, beautifully told. Yet the subtitle of his biography—"The Gentle Giant of Terror"—perhaps heralds a too sympathetic portrayal. Danton never killed anyone personally, and by the standards of the merciless Maximilien de Robespierre he was doubtless an angel. But the "marriage of boiling patriotism and moderation" that he promised electors in 1791 had deserted him when he instigated the Revolutionary Tribunal and Committee of Public Safety in 1793. He said he wanted to "create terror to save the people from doing so." In fact he created the political machinery to execute thousands.

Danton was a headstrong firebrand, a swashbuckling political showman with a prodigious memory, whose spectacular oratory held audiences in thrall. Atop the rostrum he would impugn his enemies, excite crowds to action and deflect his detractors' barbs. He would make audiences wait, even for a day, for his stirring perorations, laced with classical allusions. He was the revolution's unrivalled mouthpiece.

But his rousing words brought collateral damage. He gave the speech of his life on September 2nd 1792. Paris was threatened by foreign armies, people were petrified and Danton implored them to be "ever bolder". That same day, frenzied *sans- culottes* massacred 1,600 prisoners. Moral culpability would plague him to the end. Was Danton a dangerous demagogue? He was routinely likened to Cromwell.

At the same time Danton was a jovial family man. He adored his wife and children and the company of his friends, especially the skilled pamphleteer, Desmoulins. He eschewed Robespierre's yearnings for "moral virtue", preferring pragmatic paths to national rejuvenation. He had a genuine connection with common people.

But his passions had a macabre side. In early 1793, when he was in Belgium, mired in delicate negotiations with a renegade French general, a messenger from Paris told him that his wife, Gabrielle, had died giving birth to their fourth child. Emotionally crippled, he sped back to Paris at once, but was too late for the funeral. Undeterred, he crept into the cemetery under cloak of darkness with a bemused sculptor in tow. The trembling grave-keeper obeyed the people's champion and exhumed Gabrielle's body, and the sculptor set about his grisly task. Four months later, in a ceremony conducted by the outlawed Roman Catholic church, Danton married the 16-year-old nanny of his children.

Fear of invasion and counter-revolution made Robespierre's extreme politics more appealing and Danton lost control of events. His connection to the Paris masses waned. From the middle of 1793 the revolution took a more bloodthirsty turn. Danton's terror became a murderous rampage. He spoke out against the indiscriminate killing and urged restraint on Robespierre. "If we cannot get together to slow this down it will kill us both," he prophesied.

The carnage and injustice made Danton declare he was "sick of men". In October he retired to the country and, in his absence, Robespierre consolidated power. Danton returned to Paris to face the Revolutionary Tribunal he had created: the rebel had become the reactionary. On April 5th 1794, after a trial without evidence or witnesses, he was guillotined.

The economics of Free

Nice but tricky

Jul 16th 2009
From The Economist print edition

Free: The Future of a Radical Price. By Chris Anderson. *Hyperion; 288 pages; $26.99. Random House; £18.99*. Buy from Amazon.com, Amazon.co.uk

EVEN before its publication, "Free: The Future of a Radical Price" had prompted a heated debate online, mostly among people who had not read the book but were merely familiar with its title. Critics lambasted it for suggesting that everything ought to be free; and they attacked its author, Chris Anderson, the editor of *Wired* (and a former journalist on this newspaper), for daring to charge money for a book advancing this position. Both criticisms are unfair. The book is in fact available free in some electronic formats, and this handily illustrates its argument, which is not that everything should be free, but that more things now can be, thanks to the new business models being opened up by the tumbling prices of computer power, storage and networking.

It sounds like a big idea. But unlike "The Long Tail", Mr Anderson's previous book, "Free" lacks an elegant underlying explanation for why some of these new models work and others do not. "The Long Tail" provided an illuminating perspective on the success of internet companies such as Amazon, eBay, Google and Netflix. These very different firms, it turned out, were all exploiting the internet's capacity to open up niche markets that their bricks-and-mortar rivals, limited by a lack of physical shelf space, could not. But where "The Long Tail" revealed something unexpected and informative, "Free" often feels as though it is stating the obvious.

Advertising Archives

What a giveaway

Mr Anderson divides the idea of Free (it is capitalised throughout) into four sub-categories: cross-subsidies (give away the razor, sell the blade); advertising-supported services (from radio and television to websites); freemium (a small subset of users pay for a premium version of something, supporting a free version for the majority); and non-monetary markets (in which participants motivated by non-financial considerations develop things like open-source software and Wikipedia).

Much of this, at least in the first two categories, is old hat, as Mr Anderson, um, freely admits. Many of his examples, such as the free cookbooks given away to promote sales of Jell-O, are historical. "Free is not new," he argues, "but it is changing." What is different now, Mr Anderson argues, is that Free can be far more widely applied in the digital era. "While last century's Free was a powerful marketing method, this century's Free is an entirely new economic model," he claims.

But he never quite stands this up. Indeed, he concludes the book with a confession that Free "has to be matched with Paid". Beyond the old-fashioned cross-subsidies and free samples, some companies seem to have found new ways to make Free work, but there are not many of them, and the sustainability of others is unclear. And many of the success stories are just applying old ideas in a new field: Google can support its free e-mail service, Gmail, using profits from its online-advertising business, for example. What is new here is e-mail, not cross-subsidies or advertising. The "freemium" approach used by dotcoms such as Flickr and Skype, which is now being adopted by some newspapers online, does offer an attractive new model, but will not work for everyone.

Free is "both a familiar concept and a deeply mysterious one," Mr Anderson says at the outset. His book advances some interesting ideas about the economics of abundance, but it ultimately leaves the mystery unsolved. The idea of Free is so broad, and encompasses so many different things, that generalisations are difficult. Mr Anderson finishes his book with a list of 50 business models built around Free, presumably so that the reader can find the model that is most likely to apply in his own field. That such a long and varied list is required merely underlines how difficult it is—appropriately enough, for a book that sets off with Jell-O—to nail down such a slippery concept.

How betting online began

An easy birth

Jul 16th 2009
From The Economist print edition

You Bet: The Betfair Story—How Two Men Changed the World of Gambling. By Colin Cameron. H*arperCollins; 320 pages; $24.95 and £15.99.* Buy from Amazon.com, Amazon.co.uk

CHANCE encounters and good ideas explain the birth of most successful companies. Yet in few cases did they come together quite as serendipitously as in the creation of Betfair, one of Britain's most successful internet start-ups.

The idea was of its time, arriving at the end of the dotcom boom. And like all good ideas, it was deceptively simple. Although the internet was turning markets upside down and revolutionising relationships between consumers and companies, it had barely touched the world of betting. If Amazon could cut out bookshops and sell books directly to the public, why should one not use the internet to let people place bets with one another?

As happens with good ideas, it occurred to several people. One of them was Andrew Black, an eccentric genius, gambler and computer expert with too much time on his hands. While working on something secret for GCHQ, the British government's spying headquarters, he was locked out of his office every evening at five. Bored living alone in a little farmhouse, he came up with a model for a betting exchange. He was also a dab hand at bridge, which led to a chance encounter with Edward Wray, a trader at JPMorgan who liked his idea enough to leave the investment bank and help start Betfair.

A similar idea took root across the Atlantic. Vince Monical, a polished business consultant in San Francisco, raised $40m from venture capitalists to start Flutter. When the Betfair duo tried to raise money they realised they had been beaten to the capital markets and were politely shown the door. Though neither exchange had yet been launched, the tendency of traders to congregate where business is briskest made it clear that only one could triumph.

But almost a decade later Flutter, the likeliest-seeming victor, is gone, taken over by its erstwhile rival. The reason is that, despite the similarities between the two, Betfair's idea was better in one crucial respect. The backers of Flutter, coming from a city still drunk on the dotcom boom, were simply looking for any market that was as yet untouched by the internet. Their model was eBay, an online auction site that matched buyers with sellers. Following the same principle, they hoped with Flutter to match a person offering a bet of, say, $10 with someone who wanted to place a bet of the same value. Big gamblers were often forced to place irritatingly small bets.

By contrast, Betfair's idea for an exchange came straight out of the capital markets. A person offering a bet of $1,000 might be matched with tens of people each wishing to bet a fraction of that amount. Mr Black's model allows people to trade their opinions on almost anything—from the winner of this afternoon's horse race to America's presidential election—as easily as banks trade currencies.

The struggle between Betfair and Flutter makes compelling reading and is done justice by Colin Cameron's solidly reported, if occasionally repetitive, book. Ultimately it is a story of the power of ideas and how, perhaps unusually in business, the better one won.

The world's earliest Bible

A good read

Jul 16th 2009
From The Economist print edition

Bringing the Bible's scattered pages together online

British Library

In the beginning were the words

IF ONLY all disputes over the ownership and integrity of precious and ancient objects could be circumvented in such a neat way, and with such a benign result. Through a number of odd historical circumstances, the constituent parts of the world's oldest manuscript of the Bible—usually dated to the mid-fourth century—are located in four different places. They are the British Library in London, the University Library in Leipzig, the National Library of Russia in St Petersburg and the ancient monastery of St Catherine's on the slopes of Mount Sinai, the Bible's original home.

But as of this month, the manuscript has been "reunited" in cyberspace, thanks to a joint effort by the four institutions. The monastery agreed to collaborate only after making clear that by doing so it was not compromising its claim to be the moral owner of the whole text, known as the Codex Sinaiticus; all sides agreed to investigate the recent history of the text more deeply. So now anybody can read a more or less intact manuscript, complete with selected translation and commentary, on a website (www.codexsinaiticus.org) which has already proved hugely popular—and hence is a little slow.

How did the pages come to be so dispersed? The main surviving portion of the text was taken from the monastery—on terms which are disputed—and brought to Russia in the 19th century by a scholar called Constantin von Tischendorf. In 1933 the Soviet government sold this treasure to Britain, where its arrival caused great excitement.

In 1975 another 12 leaves and 40 fragments of the original manuscript were found by chance in the north wall of the monastery: these are known as the "new finds". At a British Library conference to launch the website, the monastery brought the exciting news of a "new new find". A few months ago, a Greek doctoral student, Nikolaos Sarris, was examining the binding on an 18th-century Greek manuscript when he spotted that pasted to the backboard was a piece of writing that might once have been part of the Codex. It has since been confirmed that the fragment, part of the book of Joshua, almost certainly came from there.

Does the fragment's use for book-binding imply a lack of respect for the Codex? Far from it, says Nicholas Pickwoad, a conservator who knows St Catherine's. An Italian traveller in the 18th century noted that the text, or at least the vast bulk of it that remained in good order, was treasured by the monks; if a page was reused, that was only because the writing had become damaged. It was the spiritual message, not the gold letters or the vellum, that the monks revered.

The race to the moon

Glory days

Jul 16th 2009
From The Economist print edition

Magnificent Desolation: The Long Journey Home from the Moon. By Buzz Aldrin. *Harmony; 366 pages; $27. Bloomsbury; £16.99.* Buy from Amazon.com, Amazon.co.uk

Rocket Men: The Epic Story of the First Men on the Moon. By Craig Nelson. *Viking Adult; 416 pages; $27.95. John Murray; £18.99.* Buy from Amazon.com, Amazon.co.uk

Getty Images

BUZZ ALDRIN'S "Magnificent Desolation" makes riveting reading even though it is 40 years since he walked behind Neil Armstrong to become the second man on the moon (that's him above). His account of landing the lunar module on the Sea of Tranquillity on July 20th 1969, and how close the team came to aborting the mission, remains a great tale. Moreover, he provides an answer of sorts to the question that has dogged him: what does it feel like to be second? "Believe it or not", he writes, "I hadn't particularly wanted to be the first man on the moon."

But Craig Nelson's massively researched "Rocket Men" provides further details on this as on much else. He goes into the politics and jockeying, from Mr Aldrin's vociferous campaign to be first, to Mr Armstrong's pulling rank (as commander of the module, he was higher in the NASA hierarchy). We learn that many senior NASA managers supported Mr Armstrong over Mr Aldrin, although initial plans had called for Mr Aldrin to be first.

Mr Nelson has conducted extensive interviews with members of the Apollo space programme and combed through NASA archives, newly declassified CIA documents and oral histories. The result is a fascinating and definitive history of the race to the moon. The two superpowers, America and the Soviet Union, were determined not only to prove their technological prowess but also to win the hearts and minds of the world.

The Soviet Union launched the first man-made satellite, *Sputnik* 1, on October 4th 1957. NASA, the American space agency, was set up within a year and President John Kennedy took up the challenge that Americans should be the first to set foot on the moon. The Russians responded by sending off Yuri Gagarin in 1961 to be the first man in orbit. But, watched by an estimated 500m people on television, the astronauts who stepped onto the moon's pockmarked surface were American.

Mr Nelson's book contains compelling portraits of the astronauts: the American heroes of the age. He documents their military test-pilot backgrounds, their all-American wholesomeness, their intelligence (Mr Aldrin had a doctorate from MIT)—and their self-serving egos. Mr Aldrin describes the rockiness of his own post-moon life: alcoholism, depression, two failed marriages and a sad end to his air-force career. He claims however to have found redemption with a third wife and a new calling as a space advocate.

Both books provide some little-known facts. We learn from Mr Nelson that William Safire, President Richard Nixon's speechwriter, had prepared a Rupert Brooke-inspired eulogy in case something went wrong ("There is some corner of another world that is forever mankind"). And we learn from both that Mr Armstrong's first job on landing on the moon was to grab a rock. Thus, if there were an emergency and they had to leave quickly, there would be at least one lunar sample.

Wolfson museums of decorative art

Big Daddy and his awkward sons-in-law

Jul 16th 2009
From The Economist print edition

A collector extraordinaire

Wolfsoniana Centro Studi

WIDELY known as Micky, Mitchell Wolfson, aged 69, is a lifelong collector who says he is still at it “big time”. This is no overstatement. So far he has acquired some 250,000 objects of decorative or propaganda art. Happily, he donates big time, too. His gifts form the core collections of two museums: the Wolfsonian in his hometown, Miami Beach, Florida; and Wolfsoniana in Genoa, Italy, his second home for 40 years. Mr Wolfson, an unashamed egoist with a lively sense of humour, says this play on the Smithsonian museums is altogether intentional.

The museums are the beneficiaries of the largest American collection of German, Italian and American political propaganda, including a bronzed terracotta bust of Mussolini in continuous profile. They are also the recipients of a vast and varied selection of arts and crafts: juke boxes, sledges, stained-glass windows, phonographs, tea cups, model aeroplanes and lots of paintings and books. On a larger scale, they have a 20-foot (six-metre) gilded section of a Pennsylvania movie theatre façade, period rooms with their chandeliers, wall panelling and rugs intact and a 1920s artist-designed children’s bedroom with inventive furniture (such as the jaunty chair pictured).

Quality matters, rarity is appreciated but beauty gives way to documentary value and particular era. Objects must have been made between 1880 and 1945 and illustrate the evolution of modern Western design. Mr Wolfson concedes that 1848 to 1985 would more accurately mirror design history. But he says philosophically, “I stick to my fiction.” It has paid off. Today, whatever its date, modern design is in vogue and prices have soared. If Mr Wolfson had bought for investment, he would have made multiple millions. But since he always intended to give his collection away, the public benefits from his canny and passionate acquiring. The depth of the museums’ holdings encourages visitors to see even such seemingly banal objects as toasters and magazine racks in a newly appreciative way.

The Wolfsonian, housed in a former 1920s warehouse, has received more than 120,000 works from its founder. In 1997 he gave the building and its contents to Florida International University. The 20,000 Italian objects at Wolfsoniana, which opened in 2005, are displayed in a former high school in the smart seaside district of Nervi. He gave that collection to the region of Liguria to be run by the commune of Genoa.

In addition to their permanent collections, the museums stage special exhibitions. The large show now open in Italy, “Thermal Deco”, spotlights objects designed by Galileo Chini between 1912 and 1923 for the Berzieri thermal baths at Salsomaggiore. An exhibition about the design of old American cars will open in October in Miami Beach. It is bound to be both romantic and poignant, surveying the car industry’s impact on American life during Detroit’s golden age.

Mr Wolfson travels too much in pursuit of treasure and pleasure to be a micromanager. But he remains involved with both museums and the people running them. His marriage to an Italian aristocrat was dissolved decades ago. He has no offspring. He himself refers to the museums as his children. “I was the father,” he says of their conception. “The Wolfsonian and Wolfsoniana were the daughters. Florida International University and the region of Liguria were the husbands.” (There is no mention of a mother but money comes to mind. In 1983 his father left a reported billion-dollar estate.)

Alas, this daddy did not anticipate that bureaucracies would make tricky sons-in-law. Contrary to his expectations, the museums do not share a website. Nor is there an easy exchange of objects, research or

staff. But at the time of his donations he astutely held on to 25% of his collection and he owns what he has bought since.

This potential inheritance gives him leverage with bureaucrats. So do his personal and professional contacts. He has published the *Journal of Decorative and Propaganda Art* since 1986 and is an active member of the international boards of the Museum of Modern Art in New York and the Musée des Arts Décoratifs in Paris. As a New York art pundit put it, in the design world "all roads lead to Micky."

Correction: Yuri Zhivago

Jul 16th 2009
From The Economist print edition

In “Yearning to be free” (July 4th) we inadvertently implied that Lara was married to Yuri Zhivago. Our shamefaced apologies to Boris Pasternak; his famous lovers of course never married.

John Bachar

Jul 16th 2009
From The Economist print edition

John Bachar, free-climber, died on July 5th, aged 52

Karl Bralich

THE rocks of the southern California mountains, in the Joshua Tree National Monument and the Yosemite Valley, rise in polished granite towers from the desert floor. For most of the daylight hours, the wildlife of the place—coyotes, ground squirrels, lizards, road-runners—seek rare, small spots of shade. But in recent years knots of people often gathered there to watch an odder creature creeping, by feet and hands alone, across the high sheer face of boulder, buttress or cliff.

John Bachar climbed slowly, like a spider—or, as he preferred to say, a starfish. He seemed to move in slow motion, swinging his legs out in parallel to seek a ledge, pulling to a crouch, raising one graceful arm to grab a hold. Nothing was hurried; all was smooth and unforced. Being southern Californian to the core, there was an air of the surfer about him. He climbed sometimes in skimpy black singlet and white jeans, sometimes in minute running shorts, with his long blond hair dangling as he inched across a layback or relaxed, hanging by his fingertips, for a while. His only equipment, apart from rubber-soled boots, was a bag of chalk slung at the back of his belt, into which he dipped his hands to dry the sweat and improve his grip. He had no ropes, bolts or pitons, and preferably no knowledge of the ascent except what he had gleaned from the ground, telling himself "Dude, there's some holds here, man." There was just John Bachar, working out the rock. He could only have been more pure, he said, if he had gone up naked.

Wouldn't he fall? He seemed to be catching on nothing: propping his boot on a pimple, gripping a "smear" or a hairline crack, freeing both arms from the rock to make a lunge. More than 50 feet up one mistake meant death, and he was often on faces of 200 feet or more. He was, he admitted, terrified of heights. But he had got over it, practising his moves first on boulders from which he could fall five feet onto sand, gradually working higher, until some hundred feet up he could confidently climb with his palms open and relaxed, as calmly as if he was walking to the store. Did he ever dare look down? "Of course. It's beautiful up there." Besides, "just looking down isn't going to kill you."

To become the world's best free-climber, as he had set out to be and as, in the 1970s and 1980s, he was, took years of training. At 14 he was a weakling who could do only two pull-ups; at 16, when he made his first free ascent at Joshua Tree, he could do 27. By his mid-20s he had mastered doing pull-ups with one arm, or with 140lb of weights. Tightrope-walking helped his balance. At Camp IV in Yosemite he

built his own gym among the trees, in which he and his fellow ponytailed dreamers trained to be "masters of stone".

The training was also mental. He made himself relax and concentrate until all he saw was the "little circle of rock" ahead of him, and all he was thinking of was the fluidity and perfection of his moves. If he needed a surge of strength, he imagined throwing an electric switch to flood his muscles with power. He pictured his fingers as steel hooks, himself as a dancer. It was better to backtrack, every move elegantly reversed, than to climb in a clumsy or scrappy way.

Working by numbers

Craziness was also necessary. Mr Bachar's fellow-climbers often thought him mad—mad to free-climb on faces such as the 400-foot New Dimensions in Yosemite, and especially, in 1981, to leave a note at Camp IV offering $10,000 to anyone who could follow him, unroped, for a day. No one tried that challenge. His first safety tip was to give free-climbing up. He never took his own advice. He found it as cool and addictive as "being on another planet". And it was the only professional sport with no coaches or rule-books, where each climber planned his tactics himself. It was, in his own soft words, the real deal.

Yet his climbing was the reverse of reckless. He was a mathematician and the son of a mathematician, majoring in maths at UCLA until he dropped out to climb rocks. Each venture up a rock face was, for him, an act of analysis. Each boulder problem was mentally broken into sections before he started. Even his mental state he divided into three zones. Zone one, no harm if he fell; zone two, hospital, but he'd survive; zone three, death if he made a mistake.

Unlike mountaineers, he felt no urge to conquer the rock-face. Getting to the top didn't matter. All that counted was the grace, control and style of how he got there. The rock was his superior and, he felt, should remain as if he had never climbed it. He was horrified to find, when free-climbing in France, that holds had been chiselled in the rock face and stone-like grips glued on. He was offended to come across rusty bolts, or so-called free-climbers setting advance protection for themselves. The effect of all this was to "lower the rock to your level", removing its capacity to challenge and surprise.

By the same token, if he escaped after making a mistake, the rock had merely let him get away with it. He got away many times; a bruised back was the worst injury he suffered until, on July 5th, he fell from Dike Wall in the eastern Sierra. He must have made some move that was ugly, clumsy or distracted. If he had kept the climb focused and beautiful, he could not possibly have died.

Overview

Jul 16th 2009
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America's seasonally adjusted inflation rate accelerated to 0.7% in June following a 0.1% increase in May, with rising petrol prices causing most of the increase. But the consumer-price index remains 1.4% lower than in June last year.

Industrial production in **America** fell by 0.4% in June, which was the smallest monthly decline this year, but left industrial production 13.6% lower than last year.

China's GDP growth accelerated from 6.1% in the first quarter to 7.9% in the second quarter as a stimulus package took effect.

In **Britain** the unemployment rate for the three months to May increased by 0.9 percentage points over the previous quarter to reach 7.6%. This quarterly increase is the largest since 1981. 753,000 more people are now out of work than in May last year. Britain's annual rate of consumer-price inflation slowed to 1.8% in June, the first time since September 2007 that it has fallen below the Bank of England's 2% target.

Euro area industrial production edged up 0.5% in May over the previous month, with capital goods making the strongest contribution. But industrial production is still 17% lower than in May 2008. Inflation in countries that use the euro fell to –0.1% in June, down from zero in May.

Authorities in **Singapore** reckon that the island nation's GDP rose by 20.4% at an annualised rate in the second quarter. But GDP was still 3.7% lower than a year earlier.

Output, prices and jobs

Jul 16th 2009
From The Economist print edition

Output, prices and jobs

% change on year ago

	Gross domestic product				Industrial production	Consumer prices			Unemployment
	latest	qtr*	2009†	2010†	latest	latest	year ago	2009†	rate‡, %
United States	−2.5 Q1	−5.5	−2.7	+2.0	−13.6 Jun	−1.4 Jun	+5.0	−0.4	9.5 Jun
Japan	−8.8 Q1	−14.2	−6.1	+1.0	−29.5 May	−1.1 May	+1.3	−1.1	5.2 May
China	+7.9 Q2	na	+7.2	+7.6	+10.7 Jun	−1.7 Jun	+7.1	−0.5	9.0 2008
Britain	−4.9 Q1	−9.3	−3.7	+1.1	−11.9 May	+1.8 Jun§	+3.8	+1.7	7.6 May††
Canada	−2.1 Q1	−5.4	−2.2	+1.9	−9.9 Apr	+0.1 May	+2.2	+0.6	8.6 Jun
Euro area	−4.9 Q1	−9.8	−4.4	+0.6	−17.0 May	−0.1 Jun	+4.0	+0.4	9.5 May
Austria	−3.5 Q1	−10.6	−3.2	+0.2	−10.9 Apr	nil Jun	+3.9	+0.5	4.3 May
Belgium	−3.0 Q1	−6.2	−3.5	+0.4	−19.9 Apr	−1.1 Jun	+5.8	+0.4	11.0 May‡‡
France	−3.2 Q1	−4.8	−2.9	+0.7	−13.4 May	−0.5 Jun	+3.6	+0.2	9.3 May
Germany	−6.9 Q1	−14.4	−6.0	+0.6	−18.1 May	+0.1 Jun	+3.3	+0.2	8.3 Jun
Greece	+0.3 Q1	−4.6	−3.0	−0.9	−7.2 May	+0.5 Jun	+4.9	+0.4	9.4 Apr
Italy	−6.0 Q1	−10.1	−5.0	+0.4	−19.8 May	+0.6 Jun	+3.8	+0.9	7.3 Q1
Netherlands	−4.5 Q1	−10.7	−4.5	+0.7	−12.7 May	+1.4 Jun	+2.6	+1.3	4.5 May††
Spain	−3.0 Q1	−7.4	−3.8	−0.6	−22.3 May	−1.0 Jun	+5.0	−0.3	18.7 May
Czech Republic	−3.4 Q1	−12.9	−3.0	+1.2	−22.0 May	+1.2 Jun	+6.7	+1.7	8.0 Jun
Denmark	−4.1 Q1	−4.2	−3.7	+0.6	−16.5 May	+1.2 Jun	+3.8	+1.2	3.5 May
Hungary	−6.7 Q1	−9.6	−6.0	−1.0	−22.1 May	+3.7 Jun	+6.7	+3.3	9.8 May††
Norway	+1.5 Q1	−1.8	−2.0	+0.5	−7.8 May	+3.4 Jun	+3.4	+2.0	3.1 Apr***
Poland	+0.8 Q1	na	−0.8	+1.5	−5.2 May	+3.5 Jun	+4.6	+2.5	10.8 May‡‡
Russia	−9.5 Q1	na	−5.0	+2.0	−12.1 Jun	+11.9 Jun	+15.2	+12.1	9.9 May‡‡
Sweden	−6.5 Q1	−3.6	−5.1	+1.1	−21.9 May	−0.6 Jun	+4.3	−0.3	9.0 May‡‡
Switzerland	−2.4 Q1	−16.0	−2.2	+0.4	−9.4 Q1	−1.0 Jun	+2.9	−0.5	3.8 Jun
Turkey	−13.8 Q1	na	−4.5	+1.2	−17.4 May	+5.7 Jun	+10.6	+6.2	14.9 Apr‡‡
Australia	+0.4 Q1	+1.5	−0.2	+1.7	−0.7 Q4	+2.5 Q1	+4.2	+1.8	5.8 Jun
Hong Kong	−7.8 Q1	−16.1	−6.0	+1.1	−10.2 Q1	+0.1 May	+5.6	+1.0	5.3 May††
India	+5.8 Q1	na	+5.5	+6.4	+2.7 May	+8.6 May	+7.8	+5.2	6.8 2008
Indonesia	+4.4 Q1	na	+2.4	+3.1	+1.5 Apr	+3.7 Jun	+11.0	+4.2	8.1 Feb
Malaysia	−6.2 Q1	na	−3.0	+1.2	−11.1 May	+2.4 May	+3.8	−0.4	4.0 Q1
Pakistan	+5.8 2008**	na	+1.3	+2.3	−14.1 Apr	+13.1 Jun	+21.5	+12.0	5.2 2008
Singapore	−3.7 Q2	+20.4	−8.6	+1.3	+2.0 May	−0.3 May	+7.5	−0.2	3.3 Q1
South Korea	−4.2 Q1	+0.5	−5.0	+0.6	−9.0 May	+2.0 Jun	+5.5	+1.6	4.0 Jun
Taiwan	−10.2 Q1	na	−6.9	+0.5	−18.2 May	−2.0 Jun	+5.0	−1.3	5.8 May
Thailand	−7.1 Q1	−7.3	−4.5	+1.9	−10.0 May	−4.0 Jun	+8.8	−1.0	2.1 Apr
Argentina	+2.0 Q1	+0.2	−3.5	+0.5	−12.2 May	+5.3 Jun	+9.3	+7.0	8.4 Q1‡‡
Brazil	−1.8 Q1	−3.3	−1.5	+2.7	−11.3 May	+4.8 Jun	+6.1	+4.7	8.8 May‡‡
Chile	−2.1 Q1	−2.4	−1.0	+2.2	−10.5 May	+1.9 Jun	+9.5	+2.1	10.2 May††‡‡
Colombia	−0.6 Q1	+0.9	−1.2	+2.5	−14.5 Apr	+3.8 Jun	+7.2	+5.0	12.1 Apr‡‡
Mexico	−8.2 Q1	−21.5	−7.1	+2.8	−13.2 Apr	+5.7 Jun	+5.3	+5.5	5.3 May‡‡
Venezuela	+0.3 Q1	na	−4.1	−2.7	−0.9 Jan	+27.4 Jun	+32.2	+30.2	8.1 Q1‡‡
Egypt	+4.3 Q1	na	+4.0	+3.8	+5.7 Q4	+10.0 Jun	+20.2	+9.7	9.4 Q1‡‡
Israel	+0.5 Q1	−3.6	−1.0	+1.6	−10.4 Apr	+3.6 Jun	+4.8	+2.7	7.6 Q1
Saudi Arabia	+4.2 2008	na	−1.0	+3.1	na	+5.5 May	+10.4	+4.3	na
South Africa	−1.3 Q1	−6.4	−2.2	+3.1	+8.0 May	+8.0 May	+11.7	+6.6	23.5 Mar‡‡
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*									
Estonia	−15.1 Q1	na	−13.0	−3.0	−30.0 May	−0.9 Jun	+11.4	nil	13.9 Apr
Finland	−7.6 Q1	−10.3	−5.6	−0.1	−23.2 May	−0.1 Jun	+4.4	+0.3	8.6 May
Iceland	−3.9 Q1	−13.6	−12.1	−0.7	+10.1 2008	+12.2 Jun	+12.7	+12.5	8.7 May‡‡
Ireland	−8.5 Q1	−5.7	−7.5	−2.8	−4.2 May	−5.4 Jun	+5.0	−3.5	11.9 Jun
Latvia	−18.0 Q1	na	−17.0	−4.0	−19.3 May	+3.4 Jun	+17.7	+2.5	17.4 Apr
Lithuania	−13.6 Q1	−35.8	−15.0	−4.5	−19.3 May	+4.2 Jun	+12.5	+5.5	8.7 Apr‡‡
Luxembourg	−5.2 Q4	−16.8	−5.0	−0.9	−38.9 Mar	−0.3 May	+4.0	+0.5	5.5 Apr‡‡
New Zealand	−2.2 Q1	−2.7	−2.6	+0.7	−7.2 Q4	+1.9 Q2	+4.0	+1.4	5.0 Q1
Peru	+0.5 May	na	+1.3	+2.6	−13.6 Apr	+3.1 Jun	+5.7	+3.8	8.5 May‡‡
Philippines	+0.4 Q1	−8.9	−1.8	+2.3	−15.5 Apr	+1.5 Jun	+11.4	+2.9	7.5 Q2‡‡
Portugal	−3.7 Q1	−6.2	−4.1	−0.3	−7.9 May	−1.6 Jun	+3.4	−0.7	8.9 Q1‡‡
Slovakia	−5.6 Q1	na	−5.0	+0.7	−23.9 May	+2.4 Jun	+4.6	+1.6	11.4 May‡‡
Slovenia	−8.5 Q1	na	−5.0	+0.5	−19.8 May	+0.3 Jun	+7.0	+1.1	8.8 Apr‡‡
Ukraine	−8.0 Q4	na	−12.0	+1.0	−31.8 May	+15.0 Jun	+29.3	+16.0	2.6 May
Vietnam	+4.5 Q2	na	+2.1	+4.9	+8.2 Jun	+3.9 May	+25.2	+6.0	4.6 2007

*% change on previous quarter, annual rate. †*The Economist* poll or Economist Intelligence Unit estimate/forecast. ‡National definitions. §RPI inflation rate -1.6 in June. **Year ending June. ††Latest three months. ‡‡Not seasonally adjusted. ***Centred 3-month average

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; Centre for Monitoring Indian Economy; OECD; ECB

The Economist commodity-price index

Jul 16th 2009
From The Economist print edition

The Economist commodity-price index

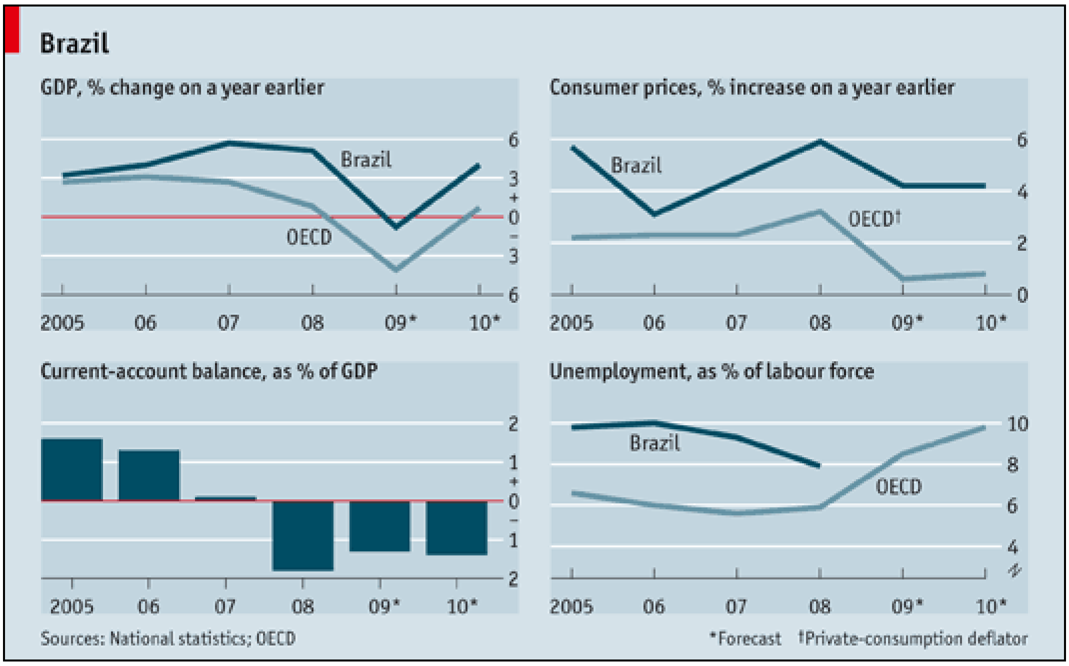
2000=100

	Jul 7th	Jul 14th*	% change on one month	% change on one year
Dollar index				
All items	178.7	178.5	-4.1	-32.7
Food	195.7	196.3	-5.7	-26.8
Industrials				
All	156.7	155.5	-1.4	-40.5
Nfa†	125.7	129.9	+0.9	-36.5
Metals	173.7	169.4	-2.4	-42.0
Sterling index				
All items	167.4	166.3	-3.1	-17.1
Euro index				
All items	118.0	118.4	-4.5	-22.9
Gold				
$ per oz	925.00	921.00	-0.8	-6.6
West Texas Intermediate				
$ per barrel	62.53	59.50	-15.9	-57.1

*Provisional †Non-food agriculturals.

Brazil

Jul 16th 2009
From The Economist print edition



Trade, exchange rates, budget balances and interest rates

Jul 16th 2009
From The Economist print edition

Trade, exchange rates, budget balances and interest rates

	Trade balance* latest 12 months, $bn	Current-account balance latest 12 months, $bn	Current-account balance % of GDP 2009†	Currency units, per $ Jul 15th	Currency units, per $ year ago	Budget balance % of GDP 2009†	Interest rates, % 3-month latest	Interest rates, % 10-year gov't bonds, latest
United States	−674.4 May	−628.3 Q1	−3.0	–	–	−13.7	0.25	3.57
Japan	+5.1 May	+107.7 May	+1.9	93.9	105	−6.8	0.41	1.33
China	+286.7 Jun	+426.1 Q4	+7.2	6.83	6.81	−4.3	1.42	3.59
Britain	−145.4 May	−52.5 Q1	−1.7	0.61	0.50	−13.9	1.05	3.79
Canada	+21.1 May	−3.9 Q1	−1.8	1.12	1.00	−2.1	0.24	3.64
Euro area	−54.7 Apr	−146.2 Apr	−1.0	0.71	0.63	−5.9	0.98	3.30
Austria	−5.4 Apr	+15.0 Q4	+2.0	0.71	0.63	−4.6	0.99	4.07
Belgium	+5.0 Mar	−12.0 Mar	−2.4	0.71	0.63	−5.8	1.00	3.94
France	−73.9 May	−59.4 May	−2.2	0.71	0.63	−6.6	0.99	3.70
Germany	+196.3 May	+171.0 May	+3.9	0.71	0.63	−4.6	0.99	3.36
Greece	−58.8 Mar	−45.2 Apr	−8.8	0.71	0.63	−6.5	0.99	5.01
Italy	−11.9 May	−69.6 Apr	−2.8	0.71	0.63	−5.2	0.99	4.45
Netherlands	+44.8 Apr	+50.0 Q1	+6.1	0.71	0.63	−4.1	0.99	3.81
Spain	−109.3 Apr	−124.7 Apr	−7.2	0.71	0.63	−9.6	0.99	4.05
Czech Republic	+4.1 May	−6.3 May	−1.9	18.4	14.6	−4.7	2.09	5.73
Denmark	+6.5 May	+8.5 May	+1.5	5.29	4.71	−2.5	2.06	3.79
Hungary	+1.3 May	−11.3 Q1	−2.9	194	146	−3.9	9.56	10.02
Norway	+61.0 Jun	+79.6 Q1	+12.5	6.38	5.10	7.2	1.88	4.05
Poland	−18.2 Apr	−15.7 May	−5.7	3.04	2.04	−4.0	4.27	6.18
Russia	+132.5 May	+55.3 Q2	+0.9	31.9	23.3	−8.0	11.00	11.15
Sweden	+12.8 May	+31.4 Q1	+7.0	7.78	6.02	−4.7	0.11	3.35
Switzerland	+17.9 May	+56.6 Q1	+7.6	1.08	1.02	−3.1	0.37	2.19
Turkey	−51.0 May	−23.8 May	−0.7	1.53	1.22	−5.6	9.54	6.53‡
Australia	+6.6 May	−29.8 Q1	−4.1	1.25	1.03	−4.2	3.19	5.45
Hong Kong	−21.7 May	+29.3 Q1	+10.4	7.75	7.80	−4.0	0.27	2.24
India	−96.4 May	−29.8 Q1	−1.9	48.6	43.1	−7.8	3.23	7.54
Indonesia	+10.4 May	−0.8 Q1	+0.9	10,122	9,141	−3.0	7.36	7.23‡
Malaysia	+39.7 May	+40.5 Q1	+12.3	3.56	3.23	−7.8	2.10	2.41‡
Pakistan	−16.8 Jun	−12.2 Q1	−2.1	82.2	71.2	−5.0	11.72	14.50†
Singapore	+17.0 May	+23.1 Q1	+14.9	1.45	1.35	−4.1	0.50	2.22
South Korea	+15.2 Jun	+17.2 May	+2.9	1,279	1,009	−5.7	2.41	4.96
Taiwan	+12.8 Jun	+29.2 Q1	+9.6	33.0	30.4	−5.2	0.85	1.43
Thailand	+10.6 May	+8.3 May	+5.3	34.1	33.5	−5.6	1.40	3.01
Argentina	+15.8 May	+6.8 Q1	+2.0	3.81	3.03	−1.2	14.56	na
Brazil	+27.5 Jun	−20.7 May	−1.3	1.94	1.60	−2.0	9.16	6.16‡
Chile	+4.5 Jun	−4.3 Q1	−0.9	543	491	−4.1	1.20	2.50‡
Colombia	nil Apr	−6.5 Q1	−3.7	2,021	1,764	−3.4	5.19	6.06‡
Mexico	−15.5 May	−14.2 Q1	−2.7	13.7	10.3	−5.4	4.55	7.85
Venezuela	+32.5 Q1	+26.2 Q1	+1.1	6.54	3.40§	−4.7	14.51	6.55‡
Egypt	−26.1 Q1	−2.9 Q1	−1.5	5.58	5.31	−7.1	10.24	3.03‡
Israel	−9.2 Jun	+4.1 Q1	+1.7	3.93	3.35	−6.2	0.35	3.80
Saudi Arabia	+197.4 2008	+124.0 2008	−2.1	3.75	3.75	−5.1	0.65	na
South Africa	−5.8 May	−18.7 Q1	−5.8	8.18	7.61	−4.1	7.63	9.21
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*								
Estonia	−2.5 May	−0.8 May	−3.3	11.1	9.89	−3.7	6.28	na
Finland	+6.7 Apr	+4.2 May	+0.8	0.71	0.63	−2.6	0.97	3.77
Iceland	+0.3 Jun	−6.1 Q1	+3.6	128	78.0	−12.0	8.00	na
Ireland	+47.6 Apr	−11.3 Q1	−2.2	0.71	0.63	−12.6	0.99	5.35
Latvia	−4.3 May	−1.7 May	−2.0	0.50	0.44	−8.0	13.61	na
Lithuania	−4.3 May	−2.2 May	−2.0	2.45	2.18	−6.1	8.38	na
Luxembourg	−7.3 Apr	+2.2 Q1	na	0.71	0.63	−3.7	0.99	na
New Zealand	−2.2 May	−11.8 Q1	−7.1	1.54	1.30	−6.7	3.75	5.72
Peru	+1.9 May	−3.8 Q1	−2.9	3.02	2.82	−2.3	2.00	na
Philippines	−6.9 Apr	+5.1 Mar	+2.7	48.1	45.5	−2.9	4.00	na
Portugal	−30.7 Apr	−25.8 Apr	−9.9	0.71	0.63	−6.0	0.99	4.32
Slovakia	−0.3 May	−5.7 Apr	−7.0	21.4	19.2	−5.5	1.35	4.32
Slovenia	−3.4 May	−2.1 Apr	−1.7	0.71	0.63	−5.1	0.99	na
Ukraine	−13.4 Q1	−10.1 Q1	−0.3	7.71	4.62	−4.3	11.81	na
Vietnam	−5.0 Jun	−7.0 2007	−10.2	17,806	16,827	−8.8	8.04	6.87

*Merchandise trade only. †The Economist poll or Economist Intelligence Unit forecast. ‡Dollar-denominated bonds. §Unofficial exchange rate.

Markets

Jul 16th 2009
From The Economist print edition

Markets

	Index Jul 15th	% change on one week	% change on Dec 31st 2008 in local currency	% change on Dec 31st 2008 in $ terms
United States (DJIA)	8,616.2	+5.4	-1.8	-1.8
United States (S&P 500)	932.7	+6.0	+3.3	+3.3
United States (NAScomp)	1,862.9	+6.6	+18.1	+18.1
Japan (Nikkei 225)	9,269.3	-1.6	+4.6	+1.0
Japan (Topix)	866.4	-2.5	+0.8	-2.6
China (SSEA)	3,347.3	+3.5	+75.1	+74.9
China (SSEB, $ terms)	203.3	+3.4	+83.6	+83.3
Britain (FTSE 100)	4,346.5	+5.0	-2.0	+11.9
Canada (S&P TSX)	10,215.5	+5.8	+13.7	+25.2
Euro area (FTSE Euro 100)	755.7	+6.4	+1.3	+2.6
Euro area (DJ STOXX 50)	2,451.0	+7.0	+0.1	+1.5
Austria (ATX)	2,093.4	+5.4	+19.6	+21.2
Belgium (Bel 20)	2,082.3	+6.2	+9.1	+10.5
France (CAC 40)	3,171.3	+5.4	-1.5	-0.1
Germany (DAX)*	4,928.4	+7.8	+2.5	+3.8
Greece (Athex Comp)	2,185.5	+1.0	+22.3	+24.0
Italy (S&P/MIB)	19,130.0	+6.6	-1.7	-0.4
Netherlands (AEX)	260.8	+6.6	+6.1	+7.5
Spain (Madrid SE)	1,029.7	+5.8	+5.5	+6.9
Czech Republic (PX)	949.7	+7.6	+10.7	+16.4
Denmark (OMXCB)	270.0	+2.0	+19.4	+20.9
Hungary (BUX)	15,940.9	+10.1	+30.2	+28.2
Norway (OSEAX)	330.4	+5.4	+22.3	+34.2
Poland (WIG)	31,696.3	+6.6	+16.4	+13.5
Russia (RTS, $ terms)	887.9	-0.2	+46.7	+40.5
Sweden (OMXS30)†	820.9	+5.6	+23.9	+26.0
Switzerland (SMI)	5,473.3	+3.5	-1.1	-2.3
Turkey (ISE)	37,914.0	+2.0	+41.1	+42.3
Australia (All Ord.)	3,917.5	+4.0	+7.1	+22.0
Hong Kong (Hang Seng)	18,258.7	+3.0	+26.9	+26.9
India (BSE)	14,253.2	+3.5	+47.7	+48.0
Indonesia (JSX)	2,123.3	+1.9	+56.7	+68.7
Malaysia (KLSE)	1,097.2	+3.0	+25.1	+21.5
Pakistan (KSE)	7,686.2	+2.8	+31.1	+26.2
Singapore (STI)	2,389.4	+5.7	+35.6	+34.6
South Korea (KOSPI)	1,420.9	-0.7	+26.4	+24.5
Taiwan (TWI)	6,738.6	+1.1	+46.8	+46.1
Thailand (SET)	587.9	+2.1	+30.6	+33.4
Argentina (MERV)	1,603.8	+8.5	+48.5	+34.8
Brazil (BVSP)	51,296.0	+4.3	+36.6	+63.9
Chile (IGPA)	15,220.1	+3.8	+34.4	+57.9
Colombia (IGBC)	9,747.1	-0.7	+28.9	+43.4
Mexico (IPC)	25,336.3	+8.0	+13.2	+14.5
Venezuela (IBC)	45,418.2	+1.5	+29.4	+39.3
Egypt (Case 30)	5,467.6	-1.0	+19.0	+17.4
Israel (TA-100)	812.1	+3.4	+44.0	+38.4
Saudi Arabia (Tadawul)	5,631.8	+4.0	+17.3	+17.3
South Africa (JSE AS)	23,569.2	+7.1	+9.6	+23.9
Europe (FTSEurofirst 300)	863.3	+5.7	+3.8	+5.1
World, dev'd (MSCI)	972.2	+5.5	+5.7	+5.7
Emerging markets (MSCI)	766.1	+3.6	+35.1	+35.1
World, all (MSCI)	246.9	+5.3	+8.4	+8.4
World bonds (Citigroup)	807.0	+0.3	-0.4	-0.4
EMBI+ (JPMorgan)	443.4	+0.9	+13.2	+13.2
Hedge funds (HFRX)§	1,077.3	nil	+5.6	+5.6
Volatility, US (VIX)	25.9	31.3	40.0	(levels)
CDSs, Eur (iTRAXX)‡	130.0	-6.8	-35.7	-34.8
CDSs, N Am (CDX)‡	192.1	-3.7	-17.7	-17.7
Carbon trading (EU ETS) €	14.5	+8.7	-10.0	-8.8

*Total return index. †New series. ‡Credit-default swap spreads, basis points. Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; JPMorgan Chase; Bank Leumi le-Israel; CBOE; CMIE; Danske Bank; EEX; HKMA; Markit; Standard Bank Group; UBS; Westpac. §Jul 14th

Foreign-exchange reserves

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Data compiled by the IMF highlight the massive stockpile of foreign-exchange reserves held by emerging and developing economies. The numbers underscore growing imbalances in savings and trade between them and the world's rich countries. In June 2000 developing and emerging economies together held $689 billion in foreign reserves, or just under three-fifths of the amount then held by advanced economies. By March 2009 developing economies had accumulated $4.1 trillion in reserves, almost six times as much as in 2000 and 70% more than advanced economies. Many economists believe these imbalances created the underpinnings of the current global economic crisis.